UNFAIR COMPETITION FROM THE PUBLIC SECTOR IN THE TOURISM INDUSTRY AND TOURISM-RELATED AREAS—PART 1

Y 4.SM 1:103-12

Unfair Competition From the Public...

HEARING

BEFORE THE

SUBCOMMITTEE ON PROCUREMENT, TAXATION, AND TOURISM

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

WASHINGTON, DC, MAY 11, 1993

Printed for the use of the Committee on Small Business

Serial No. 103-12

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UNFAIR COMPETITION FROM THE PUBLIC SECTOR IN THE TOURISM INDUSTRY AND TOURISM-RELATED AREAS—PART 1

TUESDAY, MAY 11, 1993

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON PROCUREMENT,
TAXATION, AND TOURISM,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:32 p.m., in room 2359–A, Rayburn House Office Building, Washington, DC, Hon. James H. Bilbray (chairman of the subcommittee), presiding.

Chairman BILBRAY. It is my pleasure today to open the first formal hearing of the Subcommittee on Procurement, Taxation, and Tourism. I am particularly grateful that I will have assisting me, in the ranking minority position, my good friend, Richard Baker, from Louisiana, who will be here shortly. I look forward to working with him and his staff and to be receiving his comments on the issues we will undertake.

Today, the subcommittee tackles the issue of unfair competition from the public sector in the tourism industry and related industries. Tourism is an industry that is dominated by small and often family-owned operators. It is an industry that relies on the safeguards, protections, and benefits that Government at all levels provides to small business. It is also an industry that is particularly sensitive if those protecting barriers fall.

I have recently become aware of a number of concerns regarding the unfair advantages that many public agencies and nonprofit entities have in competition with private commercial entities. Today's hearing is meant to shed light on the issue and to assist this subcommittee and Congress in understanding the circumstances surrounding this issue and possible solutions.

Some issues of particular concern, and which I hope the witnesses will address, are apparent abuses of the unrelated income tax, the UBIT, by the nonprofits and other entities. It appears that with this competition, a significant amount of tax revenue is being lost and abuses of the intent of the nonprofit status is being permeated.

In addition, I believe that it is essential that the plight of the small businesses affected by this situation be highlighted. The associations that are represented here today are made up mostly of small firms. If the Government, its policies, or its benefits are hurting the small businesses of this country, I believe that it is neces-

sary that the subcommittee address those issues and find ways to rectify these situations.

Finally, the subcommittee wants to stress that it enters these and other subsequent hearings with an open mind. Our goal is to rectify any problems or misunderstandings between the public and private sector and promote a dialog that will reduce Government expenses and waste and to also assure the profitability and stability of private industries. As a member of the Armed Services Committee, I am well aware of the continued shrinkage of the Federal Government, and the desire to streamline Federal services, and, if possible, make these Federal entities self-sustaining. However, we must be careful to weigh these needs along with our duty to protect American businesses and the economies that depend upon them.

Again, I am looking forward to the testimony that will be presented here today and in subsequent hearings.

[Chairman Bilbray's statement may be found in the appendix.]

Chairman BILBRAY. At this time, I will do an introduction of the members who are coming here. We have five gentlemen who are testifying in the first panel. My good friend and longtime associate, part of the Justice Court team that I worked on many years ago, the Honorable Jim Santini, who is the Washington representative of the National Tour Association. Mr. Santini was for four terms a Member of this House. He served on the Energy and Commerce Committee and the Interior Committee, and we served in the DA's office. That was my reference to the Justice Court team back in the 1960's. I learned everything I did from Jim. He represents the National Tour Association, which is located in Alexandria, Virginia.

Mr. Gary Wight, Park Washington Association, P.O. Box 1646, Bothell, Washington; Mr. Frank Jensen, president, Helicopter Association International, from Alexandria, Virginia; Mr. George T. Snyder, president and CEO, American Bus Association; and Mr. John Bennison, vice president of Government and International Affairs of the American Society of Travel Agents.

I think we will start with Mr. Santini, and, hopefully, Mr. Baker will be here shortly. Jim.

TESTIMONY OF JAMES D. SANTINI, EXECUTIVE COMMITTEE, TRAVEL AND TOURISM GOVERNMENT AFFAIRS COUNCIL, WASHINGTON REPRESENTATIVE, NATIONAL TOUR ASSOCIATION

Mr. SANTINI. Thank you, Mr. Chairman, and members of the committee. On behalf of the Travel and Tourism Government Affairs Council, I emphasize appreciation to you and to the committee for undertaking this very serious inquiry. To relieve you and this committee, Mr. Chairman, I will do my best to summarize my testimony and then make myself available at the conclusion for any other questions that you may have.

Chairman BILBRAY. Mr. Santini, please hold for a minute. Mr. Baker has arrived, and he may have an opening statement We will come back to you.

Mr. BAKER. I thank you, Mr. Chairman. I am sorry for being a little tardy. I have a written statement for the record. I compliment you in calling the hearing. I know of the importance of un-

derstanding better what our Government does to free enterprise rather than for it sometimes. I appreciate the hearing opportunity.

Chairman BILBRAY. Thank you. Mr. Santini.

Mr. SANTINI. Right on, brother!

[Laughter.]

Mr. SANTINI. To assist the committee in understanding the basic concern of the travel and tourism industry, I have included a definition of what constitutes unfair competition that has been prepared by the National Tour Association. I will not read it now, but it attempts to sort out what we mean by that encompassing phrase "unfair competition."

Chairman BILBRAY. It will be put in its entirety into the record without objection.

Mr. SANTINI. First, I will introduce the Travel and Tourism Government Affairs Council, who supports the mission and the purpose of this hearing today. The council encompasses all segments of America's diverse, dynamic travel and tourism industry, and 37 organizations that belong to the council represent all models of transportation, accommodation, food service, travel agents, tour sales and operations, attractions, recreation facilities, as well as State and local destination marketing organizations. In addition, 12 corporate executives belong to the council at-large membership.

Travel and tourism, as the chairman knows well from his own state of origin, is a $360-billion industry, generating nearly 6.1 percent of our gross national product. It is our third largest retail industry after automobile services and grocery stores, and 6 million jobs are provided by this industry. It is our country's second largest employer, and 37 States, including the forerunner Silver State located in the western area of our country, Nevada, regard travel and tourism as one of the top three sources of jobs. During the 1980's, this industry grew at a new job rate twice as high as all other American industries.

Yet, although the travel and tourism industry is a huge industry, it is paradoxically an industry of small businesses. Nearly 99 percent of the half million firms in the travel and tourism industry are classified as small businesses according to the U.S. Small Business Administration.

For travel and tourism, unfair competition arises in two different forms: One, unfair competition from not-for-profit, tax-exempt nongovernmental organizations; and two, unfair competition from governmental agencies.

In the first category, tour operators and travel agents are the most likely segments of the industry to be impacted. Unfair competition is usually presented by such not-for-profit, tax-exempt organizations as churches, educational institutions, museums, art galleries, along with trade associations, and professional societies. These not-for-profits are usually membership organizations and have discovered that their membership base provides an excellent captive market for selling tour and travel services. The result is a loss of business and jobs for tax-paying, for-profit travel and tourism enterprises which cannot compete against unfair advantage of organizations that are exempt from Federal, corporate, State, and most State taxes as well. Other witnesses will specifically address,

Mr. Chairman, members of the committee, the examples of unfair competition from governmental entities.

As your committee focuses on the serious unfair competition experiences of small business abuses in the travel industry, I invite this committee to consider the fact that you are exposing an unfair competition cancer that is impacting a large segment of all of small business America.

In July 1986, the National Conference on Small Business, following 2 years of hearings in almost every State, and every region of this country, came to the conclusion in Washington, DC that "unfair competition" to business America was the number three most important issue impacting business America.

This year, the Small Business Legislative Council, after considering over 50 problems besieging small business throughout the United States, concluded that of all the "1993 priority issues" the unfair competition by Government and tax-favored entities was the number five issue of priority concern to the Small Business Legislative Coalition.

Finally, as recently as April 18 through April 25, the Philadelphia Inquirer presented an exhaustive investigative exposition of the multibillion-dollar world of America's so-called nonprofit industries, exposing, in several different contexts, the abuses of their unique tax-exempt status. Certainly, this sweeping indictment by the Philadelphia Inquirer encompasses the world of nonprofit sometimes run amok. However, as you, Mr. Chairman, contemplate future oversight hearings into this multibillion-dollar, nontax-paying competition for many of America's struggling small businesses, you will find much factual fodder for your investigative cannon in this Inquirer series. A copy of this extraordinary seven-part series is hereby offered to your committee for inclusion in the record of this hearing.

Chairman BILBRAY. Without objection, we will put it into the record in its entirety.

[The article may be found in the appendix.]

Mr. SANTINI. It is engrossing and entertaining reading, Mr. Chairman. The National Football League is a tax-free enterprise. The Motion Picture Academy, auto racing promoters, collection agencies, country clubs, criminals—hopefully, none of the witnesses before this committee are included in this category.

[Laughter.]

Mr. SANTINI. Half a billion dollar defense research corporation, investment houses, mail order colleges, a retail store, professional services, the Association of Druids, which has been one of your favorites and mine, Mr. Chairman, for years.

[Laughter.]

Mr. SANTINI. Foreign real estate investors, space exploration, and even a Chili Appreciation Society. As I say, this is most informative and engrossing reading. If the Philadelphia Inquirer doesn't get a Pulitzer prize for it, I'll be amazed.

Other witnesses before you today will offer specific examples of patently inequitable competition from both governmental tax-supported entities and from traditional 502(c)(3) tax-exempt entities. I will share only one example of how far out of control this competition can become.

A tax-exempt tour and travel abuse arena has reached criminal proportions. In 1993, a zoologist and Department of the Interior, Fish and Wildlife, employee, Robert Mitchell, with, obviously, a keen sense of the free enterprise system, incorporated a tax-exempt organization, allegedly to promote ecology. He has been charged with nine counts of obstructing and impeding the administration of IRS laws by inducing big game hunters to make "contributions" to the American Ecological Union, formerly known as the AEU, to arrange hunting excursions to China and Pakistan, and it is rumored that extinct species are on his list of possible targets for the hunters. Then he causes the hunters to file fraudulent income tax returns claiming charitable tax deduction contributions. This is a 1993 example of some of the extreme ongoing abuses by nontax-paying, tax-exempt organizations promoting travel and tourism activities. There are many, many more noncriminal examples of this abuse.

In conclusion, I offer the committee the following remedial responses to the tour and travel unfair competition evidence that will be offered for the committee's hearing record today.

First, your committee, Mr. Chairman, can do much to pragmatically encourage those offending nontax payers in the travel and tourism business to clean up their act. The tangible progress that we have seen since 1983, when I first got involved, is, in part, a direct result of Chairman Jake Pickle's—Democrat from Texas—Oversight Committee hearing on Ways and Means in 1987 and 1988. Your committee in 1993 will continue the deterrent impact with public exposition.

Second, council recommends that Congress address this unfair competition by directing the Internal Revenue Service to strictly enforce the Federal unrelated business income tax against all income earned by such tax-exempt organizations from travel and tourism activities. It strains credulity to believe that such activities are related to the exempt purpose of these organizations. The activities are pure revenue raisers, and, as such, should be fully subject to UBIT.

Third, it is self-explanatory.

Forth, a recent IRS Technical Advice Memorandum [TAM] by the IRS enunciates with some particularity the standards by which 501(c)(3) will be evaluated to determine if there has been a UBIT violation. The committee should emphatically urge the IRS to enforce these standards. A case example follows of a very well-known national nonprofit organization serving many worthwhile and useful causes and purposes. But they venture into the travel and tourism business. In one, they used a for-profit operator. In the other two cases, they conducted an in-house tour business.

In the course of the IRS investigation of this particular nonprofit, the IRS laid out the factors which must be met to show the "relatedness" is significant. Please see page five of the testimony that I have submitted for those four factors. But, the IRS is getting into the issue, with a degree of emphasis and particularity that never existed before.

Further evidence of intensified scrutiny by the IRS into travel and tourism business activity by nonprofits can be seen in the 1993

Announcement 93-2 that is directed to proposed examination guidelines for colleges and universities. Again, it says,

> We are looking into unrelated business income activities by the universities and colleges. In specific, we are looking at their operation of hotels and motels. We are looking at their operation of travel tours.

Mr. SANTINI. The IRS is honing in on perceived business activities in violation of the unrelated business income tax law.

In conclusion, I commend this committee for instituting public focus and attention to this basic survival challenge to the American small business travel and tourism industry.

Thank you, Mr. Chairman, and members of the committee, for permitting me to testify today.

[Mr. Santini's statement, with attachments, may be found in the appendix.]

Chairman BILBRAY. Thank you, Mr. Santini. If you would wait, we are going to go through the entire panel. Then, we will start with questions.

The next witness is Mr. Gary Wight, of Park Washington. Mr. Wight.

TESTIMONY OF GARY WIGHT, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, NATIONAL ASSOCIATION OF RV PARKS AND CAMPGROUNDS, ACCOMPANIED BY DAVID GORIN, EXECUTIVE VICE PRESIDENT

Mr. WIGHT. Thank you, Mr. Chairman, and members of the committee. I am Gary Wight, vice president and chairman of the Government Affairs Committee for the National Association of RV Parks and Campgrounds [ARVC]. Also with me is our executive vice president, Mr. David Gorin. We welcome this opportunity to appear before the committee today.

We have submitted more detailed additional written testimony in addition to this brief synopsis.

Chairman BILBRAY. If there is no objection, it will be entered into the record in its entirety.

Mr. WIGHT. In addition, Kampgrounds of America [KOA], one of our association members, will also be submitting additional written testimony today.

Chairman BILBRAY. Everyone who wishes will have their testimony admitted in its entirety if there is no objection.

Mr. WIGHT. Thank you, Mr. Chairman. Over the last 8 years the private sector portion of this industry has approximately 434 fewer RV parks and campgrounds. The RV park campground industry is, as Mr. Jim Santini had mentioned, an industry which, in its entirety, could easily be classified as small business. I think that both parties agree that small business is where the new jobs in the future will come from, and the emphasis needs to be in small business. Just as a side note, we are looking at some numbers about small business failures. The statistics that we found showed during the first three quarters in 1991 that 65,000 small business failures occurred.

As you have suggested in your invitation, during my comments I will address solutions to the issue of unfair competition as it relates to the RV park and campground industry. We believe the so-

lutions may lie not only in new legislation, but also in administration policy changes.

I must assume our suggestions today will be taken as a first step toward a sincere effort to address the issue of unfair competition, not only for our industry, but for all tourism industry groups. Let me briefly describe the issues as experienced by our industry.

Most Federal agencies with land operate public RV parks and campgrounds with widely varying levels of amenities. In almost every case, these camping facilities are offered at below market prices, providing some customers, or I should say, consumers, with substantial benefits at great cost to our taxpayers. Let me cite several examples which may help illustrate these issues as we see it.

Our association weekly receives letters from associate members and general members of our association who raise issues of unfair competition for both Federal, State, city, and county agencies. I will give an example of each one of those, although I realize that this body will be limited to addressing, those issues relating to Federal agencies.

In Arizona, a private businessman purchases an existing campground, and with the assistance of the SBA-guaranteed loan, proceeds to upgrade and rehabilitate the facility. Thereafter, the U.S. Forest Service announces its intention to construct a 100-site, full-service facility complete with water, sewer, and electrical hook-ups within three miles of the private facility. With the standard Forest Service pricing, the public campground is likely to face severe financial consequences and potentially jeopardize an SBA-guaranteed loan. In a recent study done by the Arizona Travel Parks Association, although this relates to State parks only, they show that the State parks in Arizona lose on an annual basis about $1,050 per site per year.

A second example, in the Black Hills of South Dakota, the Forest Service, again, announces its intentions to add full-service RV hook-ups in existing campgrounds. The conservative estimate of loss revenue to the private sector in the immediate area is some $30,000. This may not seem much compared to some of the budget issues that you all address, but it is a substantial amount when you consider the size and the length of season for this area.

The city of Vassar, Michigan, proposes to build a commercial Scout campground that would likely reduce private sector revenues by an estimated $25,000 during a 3-month season. The city does not prepare a business plan or market projections and seeks to saddle taxpayers with the maintenance and upkeep on a facility that may not be needed by anyone.

We have found in our experience in the association that many of the smaller facilities, just say under 30, or even 50 sites, in most cases, there is no way they can be economical under any conditions. We heard yesterday from some of your Federal agencies, one being BLB, that you have many small facilities.

The State of Connecticut proposes a 12-percent tax on transient RV and camping sites. The State's attorney general advises that State parks are not subject to that tax. When this occurs in almost every State, the State taxes are an exception for the State-run RV parks and campgrounds.

Our written testimony prepared for this hearing details some 18 areas that I will definitely not address at this time. You can look at that at a later time. The public agencies hold an unfair advantage over private commercial operators, in addition to below-market pricing.

A major area of concern is the public sector's expanding to full services, that is, water, sewer, and electricity. At this time of huge Government deficits and budget squeezes, it is difficult to understand why Government wants to build full-service camping facilities without examining the financial viability of the facilities or the economic impact of the small business RV campground operations.

You have asked for solutions. I would like to briefly summarize our five potential solutions.

We frequently hear from public officials, as we did yesterday, that the public demands improved camping facilities with improved amenities. We had at our Government affairs conference yesterday the BLM, National Park Service, and U.S. Corps of Engineers. At that meeting, I understand that in 1987, public hearings were held to gather public opinion on future long-range plans of the U.S. Forest Service. I can only imagine that the question was asked, "What do you want?" The answer was, "We want everything."

I am sure the question was never asked, "How much additional would you be willing to pay?" Having attended many hearings, especially in local jurisdictions where these types of questions have been asked, one of our suggestions is that Federal agencies need to revise these procedures and retain professional marketing people to know how to ask for complete and credible responses when evaluating demand.

Second, I am pleased to advise the committee that our association is seeking to work cooperatively with the various Federal land management agencies to create a public and private and task force on unfair competition to seek ways to avoid future direct situations of unfair competition. Again, yesterday, this proposal was briefly presented to the four Federal agencies. My personal opinion is I thought all the agencies thought they should be pursued.

We invite you, Mr. Chairman, and members of the committee, to join the task force personally, or through staff participation, to assist Federal agencies and the private sector to seek ways to mitigate problems and work cooperatively.

Third, we would strongly recommend Federal legislation molded after NEPA that would require all Federal agencies to prepare an economic impact analysis or statement which would be done along with all program and budget requests. This statement should take into account the impacts on existing private sector businesses, the financial viability of the proposed Government project and economic terms, the cost to the taxpayer of operation of the programs or project, and the impact on tax revenue generations. Maybe NEPA should be simply reexamined at this time. In other words, I am suggesting the mechanics may already exist in part in what is referred to as the socioeconomic market effects section of NEPA.

During the scoping of issues process, we would ask that more than a cursory or superficial look at impact to small business be made. At the very least, during the scoping process, the issues that are cumulative economic impact, or unmet consumer demand for

RV park campground sites, should be made. Of course, if it is found to be a significant impact, this section could be addressed more thoroughly in the draft.

Fourth, we advocate that the GAO undertake a study of Federal activity that has a likelihood of competing with private sector enterprise to determine appropriate legislative remedies.

We hope that by working together, the examples cited today will not become additional statistics of business failure because of unfair competition.

Mr. Chairman and committee members, thank you for this opportunity to present the position of the National Association of RV Parks and Campgrounds.

[Mr. Wight's statement may be found in the appendix.]

Chairman BILBRAY. Thank you, Mr. Wight. Mr. Jensen.

TESTIMONY OF FRANK L. JENSEN, JR., PRESIDENT, HELICOPTER ASSOCIATION INTERNATIONAL [HAI]

Mr. JENSEN. Mr. Chairman and members of the committee, thank you for this opportunity to appear before you on behalf of the Helicopter Association International.

Our 1,300 member companies operate 4,000 helicopters, flying more than 2 million hours every year. By definition, all of our operator members are small businesses, and we are very heavily involved in tourism, primarily through aerial tours.

HAI believes very strongly that the appropriate role for the Government is to govern, and the commercial activity should be left to the private sector. In the current best seller, Reinventing Government, this principle is reinforced through a quote as follows:

> The word government is from a Greek word which means to steer. The job of government is to steer, not row the boat. Delivering services is rowing, and the government is not very good at rowing.

Mr. JENSEN. As a member of the Small Business Legislative Council, HAI joins with 100 other small business trade associations in calling for the establishment of a national policy on contracting which is stable and understandable, and endorsed and supported by both the legislative and executive branches. Like the others ahead of me, I commend this subcommittee for its willingness to examine the tough issue of unfair Government competition and encroachment issues which currently exist. We hope that our testimony will help highlight the need for such a policy.

In recent years, budget cutbacks have encouraged many public agencies to explore utilizing Government aircraft to perform commercial services. These Government aircraft, because of their classification as "public aircraft," do not have to adhere to any Federal aviation regulations, all of which are required of commercial operators for safety reasons. The true cost to the taxpayers of conducting these operations with Government aircraft, including not only direct and indirect costs, but also, loss of tax revenue and job base, are almost never accurately depicted. In many instances, these Government entities constitute virtual monopolies which would not be allowed to exist in the private sector. I can give examples if you choose.

The areas of most concern to the HAI membership in terms of Government encroachment into the private sector include these three. First, I will cite improper use of excess military helicopters "loaned" to State foresters by the U.S. Forest Service. The U.S. Forest Service, under the Federal Property and Administrative Services Act, loans, again, "free" military excess aircraft to State foresters such as the California Department of Forestry.

In 1981, the California Department of Forestry negotiated a 10-year lease of nine excess helicopters. They immediately canceled six of their seven helicopter contracts with the private sector. They have now replaced these with newer or later model excess helicopters. Not only does this suggest more erosion of contracts, but, in addition, the refurbishment of these "free" helicopters is costing California tax payers a small fortune. In an article in the Wall Street Journal, refurbishment cost for these free helicopters has been estimated upward of $850,000 per aircraft.

We have witnessed the California Department of Forestry using these resources on Federal fires and requesting reimbursement from the U.S. Forest Service for their services. This places them in direct competition with commercial operators and in violation of the provisions of Federal Aviation Regulations, Part 135.

The FAA, in a March 10, 1993 letter to HAI, stated,

> Governmental entities operating for compensation or hire are subject to all the same regulations that apply to nongovernmental entities conducting similar operations.

Mr. JENSEN. HAI respectfully recommends to this subcommittee that, first of all, the GSA be required to ensure that any Federal or State agency which acquires excess property use it exclusively for internal use and not to compete with the private sector.

Second, we recommend that the Forest Service be required to adhere to the guidelines of the Federal Property and Administrative Services Act, and to encourage State foresters to use the excess aircraft only on State business.

Third, that OMB, Alpha 76, and Alpha 126 studies be required of all agencies which utilize excess aircraft to enable an adequate comparison between the cost of an in-house fleet versus contracting out for aviation services.

The second major issue that we have is the use of Florida Department of Forestry excess military aircraft to perform long-term, nonemergency hurricane relief contract work when commercial assets were available. The Federal Emergency Management Agency, or FEMA, has a policy of utilizing commercial assets whenever possible. However, in the aftermath of Hurricane Hugo, the Florida Division of Forestry has been given an 8- to 10-month FEMA contract to remove debris from Federal, State, and private lands.

The helicopters involved are two excess helicopters, again, acquired solely for internal use of the Florida Division of Forestry. There are many commercial operators within Florida and nearby who are able to perform the same mission. Again, proper oversight of the excess aircraft and FAA enforcement of regulations would end this unfair competition.

Our third major issue is National Guard encroachment into the private sector. To cite a very recent local example, Mother's Day, May 9, Erickson Air, a small company from Oregon, lifted the Statue of Freedom off the Capitol Dome for cleaning and repairs. The operation went very smoothly considering the intense controversy that preceded it.

An article in Roll Call several weeks ago called our attention to the fact that the National Guard units had been training for months to perform this precision task. We protested that this is purely a commercial function and the private sector is better qualified to do the job. The Defense Department agreed with us, and in a letter to the Capitol architect cited Defense Department policy against competing with private industry, adding that the clear intent of both the executive branch and Congress is that competition with commercial industry must be avoided.

The National Guard, for the most part, follows this principle. Problems have arisen, however, with State Guard units, that often term a mission as "training" and unfairly compete with the private sector. When this subterfuge of training is used, a lose/lose situation is created. First of all, the legitimate training curriculum is not being followed for the National Guard unit. Second, the taxpayer is footing the bill for a job that would be done more economically under a private sector contract.

The National Guard Bureau in Washington follows the policy that Guard assets should be used only for the mission "to maintain combat-ready forces and conduct Federal peace time operations as dictated by the President and Congress." But the decentralized nature of the Guard makes it difficult to control the use of their assets. What happens down the line is that small businesses have to take on the National Guard Goliath, and they don't always win. It shouldn't be that way.

The HAI recommends that the National Guard Bureau be required to enforce the use of National Guard assets only for those missions which fit into the mission statement of the Guard and are not in conflict with the commercial sector. Above all, everyone must be strongly discouraged from using the specious justification of "training" to rationalize performance of unauthorized service. That is an every day occurrence.

In conclusion, again, the HAI applauds and respects the fine work done by most Federal agencies. The roles of these agencies are appropriate and necessary. However, this subcommittee surely realizes that with the upcoming base closures and defense downsizing, more and more agencies will be looking to justify their resources to the Congress and to the taxpayers. The line between public and private sector needs to be clearly defined. As the Clinton administration, again, "reinvents government," HAI asks this subcommittee to preserve the marketplace for the private sector and to protect the private sector from Government encroachment.

Thank you, Mr. Chairman.

[Mr. Jensen's statement, with attachments, may be found in the appendix.]

Chairman BILBRAY. Thank you, Mr. Jensen. Mr. Snyder.

TESTIMONY OF GEORGE T. SNYDER, PRESIDENT AND CEO, AMERICAN BUS ASSOCIATION

Mr. SNYDER. Mr. Chairman, members of the committee, my name is George Snyder. I am president and chief executive officer of the American Bus Association, which represents more than 3,500 companies involved with charter and tour motorcoach business, regular route bus service, and airport and commuter services, as well as businesses related to travel and tourism.

I welcome this opportunity to be here today to talk about the motorcoach industry and unfair competition by tax-exempt organizations and federally subsidized competition. At this point, Mr. Chairman, I ask that my text of written testimony be entered into the official record of these proceedings.

Chairman BILBRAY. Without objection, it is entered in its entirety.

Mr. SNYDER. My purpose in appearing before the subcommittee today is to express ABA's view that Federal subsidies to air and train passengers, as well as the commercial activity on the part of tax-exempt organizations, constitutes unfair competition. ABA submits that when congressional policy confers tax or other advantages on the competitors of tax-paying bus companies, those bus companies cannot compete as effectively.

The size of the bus industry is impressive. FHWA data indicates that in 1992 there were more than 600,000 buses in the U.S. fleet. Of this, only about 20,000 were commercial intercity buses. Roughly, 350,000 were publicly owned and operated buses—both transit and school. Privately owned, noncommercial buses totaled 274,000.

A recent report by Nathan Associates found that Federal subsidies to all other modes of commercial intercity transportation have continued to keep the bus industry at a competitive disadvantage. Between 1960 and 1991, commercial air and rail transportation received subsidies at least 40 times greater than the modest subsidy going to the intercity bus industry.

Each passenger trip by bus received a Federal subsidy of only 5 cents in the form of a partial exemption from the Federal fuel tax. In contrast, Amtrak passengers received a subsidy of $54.09 per trip, and commercial air carrier passengers received $6.48 per trip. Both air and rail subsidies are in the form of outlays from Federal funds and trust funds from across Federal agencies, in addition to Airport and Airway Trust Fund and Highway Trust Fund receipts.

In addition to federally subsidized competition, the industry is plagued by unfair competition. During the past several years, ABA members have faced increasing competition from, and lost business to, tax-exempt schools, colleges, universities, churches, and other groups that provide bus tour and charter service. As tax-exempt organizations, these entities enjoyed tax and other advantages unavailable to tax-paying bus companies.

The competition engaged in by tax-exempt organizations is unfair because: First, such organizations do not pay Federal, State, or local taxes; and second, such entities are exempt from many Federal and State safety regulations that apply to private operators.

ABA submits that when tax-exempt schools and churches engaged in unlawful tour and charter activity, they not only threaten the tax-paying bus industry, but also deprive the State and Federal Government of substantial tax revenues. ABA is aware of numerous schools and churches that are engaging in and promoting unlawful tour and charter activities.

Since many charter operators are small businesses, unfair competition from tax-exempt entities, together with other financial pressures, such as the high cost of liability insurance, is threatening their existence. I would like to stress that tax-exempt organizations are not required to carry the $5-million liability insurance that is required of tax-paying bus operators.

We are deeply concerned about the diversion of bus charter and tour traffic to operators who are supposedly engaged in private transportation activities, but who are actually engaged in for-hire transportation available to persons and groups having no connection or affinity with a tax-exempt organization. This type of activity is unlawful and should be curbed by the ICC and the Department of Transportation. Their passengers may not be protected by the $5-million insurance requirement applicable to interstate, for-hire, passenger motor carriers or by State insurance requirements applicable to for-hire, passenger motor carriers engaged in intrastate commerce.

We believe minimum Federal and State safety and financial responsibility requirements should apply to both private and for-hire transporters of passengers in commercial motor vehicles. We have no objection to the charter bus and tour service performed by schools, churches, and other tax-exempt organizations provided that the service is strictly limited to members of that organization and to the purposes for which tax exemption is granted.

ABA believes that existing law requires that the income derived by tax-exempt organizations from charter and tour service provided to nonmembers of the organization be taxed as unrelated business income.

We believe that this type of activity meets the three-part test established by the Internal Revenue Service in 1950 that a tax-exempt organization is taxable if the income-producing activity is: First, a trade or business; second, regularly carried on; and third, not substantially related to the organization's performance of its exempt function. ABA suggests that the IRS enforcement be designed to ensure that tax-exempt organizations do not report or mischaracterize their unrelated business income.

In conclusion, ABA believes that present law and regulations, as currently interpreted and enforced, do, in fact, permit unfair competition. To rectify this situation, ABA proposes that: First, the committee provide that commercial tour and charter activities of tax-exempt organizations not continue to be subsidized by the Federal Government; second, ABA submits that Federal regulations should not create unfair advantages for nonprofit organizations; third, regulations should be promulgated by the Department of Transportation to require exempt organizations' compliance with Federal safety regulations.

On behalf of the members of ABA, I thank the committee for the opportunity to testify on this important issue.

[Mr. Snyder's statement may be found in the appendix.]

Chairman BILBRAY. Mr. Bennison, we will take your testimony, and then the members are going to have to go over and vote. We will come back for the questions. So, as soon as you finish your testimony, you will see us get up. It is not offensive to any of you. We are not mad or anything. We are not leaving. We will come back.

TESTIMONY OF JOHN C. BENNISON, VICE PRESIDENT, GOVERNMENT AND CORPORATE AFFAIRS, AMERICAN SOCIETY OF TRAVEL AGENTS

Mr. BENNISON. Thank you, Mr. Chairman. My name is John Bennison, I am vice president of Government Affairs for ASTA, the American Society of Travel Agents. We are very pleased to be here today, and we are very happy that you have taken up this issue, for we feel it is, definitely, an important issue. Quite frankly, as Mr. Santini pointed out, we see every year that the nonprofits get more and more engaged in the commercial activities. It certainly is, therefore, not an issue that is going to go away. The playing field is clearly not level. It needs the help of this committee, and others in Congress, to see to it that the UBIT tax is enforced and other legal measures are adhered to in order to make it a fair, competitive market that we can all compete in.

Of ASTA's 20,000 members, 80 percent are small business organizations. The members we represent range in size from American Express to the small mom and pop travel agency on the corner. We have travel agents in every congressional district in the United States. I would say that our statistics show that the average travel agency employs between five and seven people and sells about $1.2 million in product every year. At a 10-percent gross profit, which is the commission that we charge, that generates $120,000 to divide amongst five employees. As you can see, there is not a lot of profit. They are not a big operation. In fact, that commission money has to cover overhead, phones, mailings, as well as the salaries of the five employees.

These facts clearly indicate that travel agencies for the most part are classified as small business. Consequently, anything that affects the price of the travel product that is unfairly competitive to us has a negative impact on us. The classic example, and I can't help but thank the Washington Post for doing my work for me, appeared today in the Washington Post. The article is entitled "Non-Profit Mail Discounts In Route to Cancellation."

The whole article is about Minnesota Public Radio—a nonprofit organization—which owns a subsidiary which raises money to help offset the cost to keep the organization going. They mailed out over 49 million catalogs last year at a very low, nonprofit rate. The catalogs were filled with nothing but commercial products for sale, such as Mickey Mouse ties for $34, $22.90 Beatles Yellow Submarine boxer shorts, coffee mugs, and $50 Betty Boop watches. Needless to say, it is hard to see the relationship between that commercial activity and that of the nonprofit radio station for which they received their nonprofit status.

Their mailing costs are 7 to 10 cents less for every item that they mail. Let's face it, the key to any travel agency is to have the abili-

ty to mail out the different brochures for the tours they are promoting, or the tickets that they are selling, or any other service they provide. A heavy part of a travel agency's cost is mail. Therefore, the unfair competitive position created by this nonprofit lower mailing cost is a classic example of the unfair conjunction going on today in the marketplace.

I would like to submit my statement for the record. I will not read it in its entirety.

Chairman BILBRAY. Without objection, it will be entered in its entirety.

Mr. BENNISON. Thank you, Mr. Chairman. I would like to, just for the record, state ASTA's position, on the commercial activities of nonprofits.

ASTA understands the desire of nonprofit organizations to raise revenues by engaging in commercial activities that are attractive to their special constituencies, or that will appeal to consumers, generally, because the activities are connected with the name of an organization that the public associates with good works. It is a sad fact, but true, that voluntary contributions and fundraising within the gamut of tax-exempt activities alone do not yield enough revenue for many nonprofit organizations to fulfill their charitable mission.

We would hope, however, that the nonprofit sector would recognize that our members, and others who share our view of the issue, are dependent upon their businesses for their livelihood. They must raise and maintain their capital in the open market and pay taxes on their profits. It is fundamentally unfair, therefore, for the tax-exempt sector to compete directly for business with the tax-paying sector and still receive the obvious economic advantages that tax exemptions provide.

The law on this subject, under substantially related standards, is actually very clear. It imposes a tax on the income from a trade or business regularly carried on by an exempt organization if the activity is not substantially related to the organization's exempt purpose. We are very concerned about how easy it is to create a nonprofit organization and get into the travel business.

A classic example, which is spelled out in detail in my submission this morning, is regarding the group called the "International Post-Graduate Medical Foundation." An individual created this foundation to provide for additional post-educational seminars for doctors. He obtained a nonprofit status. It turns out that the president of HC Travel is a trustee of this foundation, as well as president of HC Travel Agency. HC Travel got the exclusive right to handle all the tours for those doctors wanting to participate in the continuing education tour programs. The tours are 3 weeks in length, and they go to all the exotic places in the world, such as East Africa safaris, India, and the Far East.

So, here you have a situation where the foundation spent 90 percent of its income to produce these brochures, and they mailed them out. The brochures were the key ingredient in selling the doctors on these tours, and, of course, the doctors could write them off because it was supposedly an educational experience and helping their professional careers. It turns out that there is very little mention of the educational program on the tour, although there are a

couple of afternoons where there are some lectures. The doctors must buy the travel from H&L Travel Agency which does not put it out for competitive bid. The agency, which is owned by its president, who happens to be a trustee of the foundation, simply collects the money.

These facts indicate exactly what happened. The IRS is now taking the president of HC Travel to Court. In fact, it has found against him because they were totally convinced that there was no direct purpose or staff for the nonprofit organization to carry out its functions, but, in fact, it was simply in the business of selling tours.

This case is just one example of what is out in the marketplace today. It is for this reason we are very concerned and hope that this committee does continue to look into the matter. As far as our suggestion of ideas of correcting the abuses, we would suggest that you look at the press release which was issued by Chairman Pickle when he completed his hearings on the same issue about 4 years ago. I have inserted it in my statement, so, it is all there. But, I think that goes a long way to pointing out how important it is to establish what exactly is related and not related activities that these various nonprofits can engage in. Once it is clear that it is not a related activity, then the UBIT tax should be rigorously enforced, and they should have to pay their fair share of taxes on the income generated from those nonrelated commercial activities. That, in turn, will level the playing field.

I think that basically sums up where ASTA is on this issue. Most of the other points have been made by my fellow members. If you have any questions, I am delighted to take them at this time.

[Mr. Bennison's statement, with attachments, may be found in the appendix.]

Chairman BILBRAY. We will all be back shortly. We have to go vote.

[Recess.]

Chairman BILBRAY. Mr. Baker is going to be tied up for a minute. He had a 3:30 meeting. He will be right back. But we are going to go ahead. I will start the questioning.

This is probably addressed to Mr. Santini who is still out in the hall, but maybe Mr. Bennison. When we talk about the nonprofits that are encroaching in your particular area of tourism and travel, you certainly gave us an example where this position group, obviously and probably, got targeted where the doctors were trying to take it off their taxes as a legitimate educational experience. But how do you feel about the other groups? I mean, I know that my colleges and my law school always are sending me trips to Athens, and trips to Cairo, and so forth. Is that the kind of thing that you are referring to where it actually stays within the membership? Or are you talking about ones that reach out beyond the memberships?

Mr. BENNISON. Well, as was pointed out in the hearing, currently, all a nonprofit organization has to do is say that the commercial activity they are engaged in is a substantially related business to their nonprofit organization. Of course, if you are a college, you would claim that traveling is an educational experience, therefore, it is substantially related. Our argument would be, as long as they

are forth right about declaring the profits they earned from these commercial activities, and they paid their UBIT tax on those profits, we would then say that is fair competition. But if they are going to misuse the situation, utilize their free 800 numbers by having volunteers call and solicit sales for them while the university is paying all the overhead and the university's new shelters to promote their travel, we feel that is unfair. Using the low-cost, nonprofit mailing privileges instead of paying the roll for-profit organizations and travel agents have to use, then, we contend this is very unfair competition.

But if they are straightforward about it, and many universities are, by putting their programs out for bid, and they sell it through travel agents, we can support that. The travel agents, obviously, pay salaries, taxes, and all promotional and mailing costs.

I do think that there is some concern, as to the criteria for the substantially related test. One of the suggestions by Congressman Pickle's committee was that they may want the IRS to be more forceful and have a directly related test. But, at this point, that has not happened. The determination would then be, are these travel programs really directly related to the purpose for which the organization received its nonprofit tax status. If it is not, then, the nonprofit shouldn't even be in the business of selling travel.

Chairman BILBRAY. I see. Mr. Santini, what I brought up was about universities. Both you and I are alumni; you, of the University of Nevada/Reno, and, myself, the University of Nevada/Las Vegas, but we continually get brochures on travel arrangements to Mexico, Europe, and so forth. Is that the kind of activity you are talking about, too?

Mr. SANTINI. I think Mr. Bennison touched upon the response that would characterize the Council and NTA's reaction to that kind of a situation. I presently serve on the University of Nevada/Reno Alumni Council.

Chairman BILBRAY. We won't hold that against you, being from the rival school.

Mr. SANTINI. If you can overlook that indiscretion. I, as a member of that council, am involved in their tour and travel activity. We put out for bid to for-profit tour organizations or travel agencies the itinerary that we are proposing and requested them to make a bid on what that would cost and how that would be conducted.

Under our definition of unfair competition, it says, among other things, "The organization is committing unfair competition if it does not use a for-profit intermediary to provide goods and services." If the university alumni association does it internally, all on its own, without the travel agent or the tour operator intermediary, we feel that is, certainly, unfair competition and, certainly, in violation of UBIT. If they do use the intermediary, in response to your question and your concern, it is not a source of our objection.

Chairman BILBRAY. Now, you also mentioned hotels, colleges, and universities running hotels. I don't think that either of our State universities does that, that I know of. Do you have examples that they don't provide the services for parents of children coming in? I

presume they are students. Is that what you are talking about? That was mentioned here.

Mr. SANTINI. In the hotel arena, it is, and, again, referring back to the basis for our fundamental concern and interest here, that it is a tax-exempt organization, university, that sells goods or services, in this case, hotel and restaurant services, on an ongoing basis, and it is in a for-profit business. If facilities are provided for a visiting parent, they are not in the business of providing hotel, restaurant, or meeting accommodations. If, however, the university or college elects to publish a brochure inviting any and all conventioneers, any and all people who want a hotel facility, any and all people who want a restaurant, to come in and use the university facilities at a substantially reduced price compared to the neighborhood motel or hotel, then that is objectionable.

Chairman BILBRAY. Well, like the interns who come here to Washington every year. They stay in the Georgetown dorms, or the American University dorms, or George Washington. You are not referring to that type of activity, or are you?

Mr. SANTINI. When it does relate specifically to an educational activity, we don't object. For most internships, and certainly in your office, that is true.

Chairman BILBRAY. Thank you.

Mr. SANTINI. When, however, they invite somebody to come to Washington, DC, see the monuments, see Congress, see all of the attractions that Washington, DC has to offer, and offer a $15.00 a night hotel room, then that is the point of our objection, and that is the basis of our concern. Have they gone into the business of providing hotel, restaurant, or convention and visitor services.

Chairman BILBRAY. Mr. Wight, in your testimony, you got into the fact that the Government should not get into business in competition with for-profit businesses, small businesses. Yet, I am trying to remember which one of you had the testimony and was talking about the State, the city, and so forth. We, at the Federal level, can certainly monitor, and I am sure the committee will look into, and we are going to have testimony from the Government on what they are doing and why they are doing it, but can you be a little more specific?

Mr. WIGHT. Relating to that issue and talking about Federal agencies, our concern is first of all with the amenities. We believe that, yes; Americans should have the right to access to Federal lands. Yes; camping can be provided. But, the question is the level of amenities which are provided. We believe there should be a charge which is equivalent to the type of services which that Federal agency is providing. So, we are not saying, that there should be no RV parks or camping in Federal lands because we recognize that is almost an inherent right of the American public. But the idea of getting into full service amenities, that is, electrical hookups, sewer and water, full service, is where we believe that the line should be drawn on competition.

Chairman BILBRAY. Then you would want something from the Government like an economic impact statement on each one of these projects to make sure that they are self-sustaining and not money losers. Is that what you are saying?

Mr. WIGHT. Yes; especially if a new facility is being constructed, or an upgrade. That is when we are suggesting that an economic impact statement and——

Chairman BILBRAY. What effect it has on surrounding businesses?

Mr. WIGHT. Small businesses and, specifically, to our association members.

Chairman BILBRAY. I have some further questions in a minute, but I will let my colleague, Mr. Knollenberg, ask some questions and let him take part in this discussion.

Mr. KNOLLENBERG. Thank you, Mr. Chairman. I appreciate that. I have a couple of questions for Mr. Wight. You have mentioned in your testimony, and, in fact, it is written in your statement here, that you would like to see the GAO undertake a study of all Federal activity that has the likelihood or the tendency to compete with the private sector, and that their job would be to determine some appropriate legislative remedies. I wonder, would it not be possible just to draft some legislation, rather than establishing that middle ground? Maybe it is not necessary. We could just draft legislation that would, in fact, incorporate some of those ideas that you are pretty strong, pretty firm, on. Is that something you had thought about instead of this process?

Mr. GORIN. Yes; if I may, I am David Gorin, the executive vice president of the association. Yes; we certainly thought about that and going directly into legislation. But I guess it is my experience that says that before you legislate, you have to study a little bit more, and the General Accounting Office may be the way to do that, to do an inventory of existing legislation.

As Mr. Wight mentioned, there is NEPA, which does involve environmental assessment which, depending on how that was interpreted, could include economic assessment as well. We would be more than delighted to go directly to legislation, and deal with this problem without having to go through the long drawn out process of studies and more studies. We know what the problem is.

Mr. KNOLLENBERG. I would bow, obviously, to the chairman and the will of this committee in terms of what would be an appropriate way to do that, but it seems to me from your study, Mr. Wight, and you have some feelings that seem to broadly parallel what I would see or can see as being things that we should do by privatizing as many of these possibilities as we can because, certainly, it seems more efficient.

So, I commend you for the report and the commentary, in fact, from the rest of the panel in regard to the competition that goes on with the Government competing with you folks. There should be some way to draw some lines so that we can establish some clear lines, at least, where the private sector should be given the first offer. Then if there is no private sector interest, perhaps we have to deal with what is left, which would be, apparently, the Government.

Thank you, Mr. Chairman.

Chairman BILBRAY. Mr. Santini.

Mr. SANTINI. I might follow up on that logical inquiry. The Business Coalition for Fair Competition has drafted model legislation. In part, that model legislation is being seriously examined at State

level. The State of Oregon comes immediately to mind. I can get a copy of the bill.

What Oregon essentially proposes is essentially what your question embodied. They inquire about whether or not State or Government entities were going into competition with private sector, or were they in competition with services that could be provided by the private sector. If so, they create a commission within the governmental structure of Oregon to examine that situation and make a recommendation to the Governor and to the administration to alleviate that problem.

That legislative concept has been examined in Maryland. It is being examined in Wisconsin. Louisiana is a State that is taking a look at it. We feel that the idea embodied in your question is one being taken very seriously at the State level. There is no reason it shouldn't be at the Federal level as well.

Chairman BILBRAY. Mr. Wight.

Mr. WIGHT. Maybe there is one other answer to that. In a session yesterday, we were advised that the National Park Service had a task force reviewing concessionaires and how this might work. We asked who was on that task force. It was just people from the U.S. Forest Service. It seems like somebody from the private sector, at least, should be providing information. That might be a first opportunity to discuss in more length concessionaires in the Forest Service and National Park Service. I was, personally, a little bit surprised that nobody from the private sector was involved in these preliminary discussions on concessionaires.

Chairman BILBRAY. Maybe it was just because they were preliminary. We certainly can contact the Secretary of Agriculture on that, Mr. Espy, who is a former colleague and classmate of mine in the 100th Congress, and we came in together, to suggest that some input from concessionaires would be appropriate.

I do like the idea of getting a GAO report first, though, because as my colleague is probably aware, to convince the powers to be that it is needed, usually you have to have more documentation than just the industry saying there is a problem. So, if GAO would back-up what we are saying here, and that it is a serious problem.

Also, the fact we are going to have Government witnesses coming before the committee in 2 weeks. Hopefully, we will get some answers from them, including the IRS, about what they are doing to really enforce this. From the examples you gave us, it seems that it becomes totally flagrant when you have a lot of doctors or other people taking off deductions. It arises in their mind, and they find out it is a fraud. But as long as people are not trying to take it off their income tax, and the nonprofit is the only one that is not paying taxes on the income, it doesn't sound like anybody really does anything about it.

Mr. Jensen, in your testimony, I got the feeling that you feel that there is no place for the Government to be involved in competition with members of your association. Is that the case? That is what it seemed like to me.

Mr. JENSEN. No, Mr. Chairman; that is not the case at all. There are a lot of instances where the Government can perform services. For example, in Berkeley Springs, West Virginia, you go there and get a massage from the State operated massage parlor. Nobody

complains about that. That has been going on for generations there. Evidently, there is nobody who wants to go in there and set up such a facility as that. That ties right in with the tourism here.

But we object very strongly when they use Government equipment, for example, excess military helicopters, which are not certificated, and which are not maintained in accordance with the safety standards of the Federal Aviation Administration. Then to use these in head-to-head competition with the private sector, and then bury a lot of the cost under the table. When you challenge the State agency, or the county agency, or whoever is operating these helicopters, or, sometimes, the Forest Service, they say, "Well, we didn't count salary because we have to pay these people anyway." Well, what about liability insurance? "Well, we are self-insured, so we don't count liability insurance."

So, there is a very strong disparity between the cost figures that come up from these governmental entities and what the private sector comes up with. They show an unfair economic advantage. However, the good news is there is a Federal entity called ICAP, Interagency Committee on Aviation Policy, which is run by the GSA, and which is doing quite a bit to try to make a level playing field. But in the meantime, our complaint is we will compete with anybody, and probably win hands down, but we want to see a level playing field. Don't hide your salary under the table, that sort of thing.

Chairman BILBRAY. Mrs. Clayton.

Ms. CLAYTON. Thank you, Mr. Chairman. Several of these, I am just becoming familiarized with, but I am from local Government so I bring a limited perspective in some of this. At a time of fiscal constraint, there is a notion, not necessarily that I subscribe to, that Government should be more entrepreneur, not less. Therefore, in terms of trying to look at things that they do on a normal basis, it begins to provide their services for a fee.

Then there are services that local governments provide and universities. I am formally with the University of North Carolina, and there is a hotel there. Of course, its premise is that it is for the guests of the university students and educational activities. It also has a helicopter and a plane for its medical school, where it provides, and the Government is reimbursed for, its service. But I don't think they subscribe, and I was listening very carefully to your premise of your objection, where there is an antimediary provider and it is not revealed. I don't think that in their case they attempt to try to make a profit on it.

Now, if you asked in the real world, do they curtail the helicopter service that could be there? I think they do. Could you just comment on that, if that is what you are trying to get to?

Mr. JENSEN. Mr. Chairman, if that is all right, I would like to respond to that.

Chairman BILBRAY. Yes.

Mr. JENSEN. That is an excellent question, Ms. Clayton. We have just had a ruling on March 10, 1998, from the Federal Aviation Administration. It is a long convoluted answer from their legal counsel, which States that any entity, Government entity, which operates a service similar to that operated by a commercial entity, must comply with all of the Federal aviation regulations. So,

chances are the university helicopter that you are speaking of, if they are carrying patients for a fee, whether it is a profit or not, they are required to conform to the provisions of Federal Aviation Regulation, Part 135. We have just gotten this ruling, and we are just now starting to implement it. So, chances are they are not complying, and chances are they are hurting the private sector.

Ms. CLAYTON. Would a fee be reimbursed by Medicaid or Medicare if it is associated with the Duke Hospital or University of North Carolina Hospital?

Mr. JENSEN. I think the answer to that is yes. There are a lot of other entities, like the State of Maryland, which is now starting to charge patients that they move from point A to point B.

Ms. CLAYTON. So, it does not make any difference who the payor is, the payor being private insurance, the Federal Government, or an individual?

Mr. JENSEN. If money changes hands, they have to comply with the Federal aviation regulations.

Ms. CLAYTON. Would you suggest that there may be situations where the Government, in order to provide the quality of life or respond to emergency, that they are the appropriate entity to provide these services like this helicopter service? Or, even it is recreation, the massage parlor notwithstanding but some other, like camping or fuel equipment, there just may not be the economy of scale that would allow the quality of life in this community, and the local government makes a conscious decision, "This is an investment that we want to invest in because there is no private entrepreneur." The risk is too great.

Mr. GORIN. I think we certainly agree in the cases where the risk is too great and an entrepreneur is unavailable, or not interested, or not willing to assume that risk, in certain cases, it might be justified. We believe, strongly, that the role of the Government is to do things that provide for the health, safety, and welfare of its citizens. Whereby camping may be something which is good for their welfare, the degree to which that is provided is really the issue. Safe, secure, undeveloped camping facilities are certainly appropriate. I don't think if we were talking about a local town constructing a hotel for the welfare of its citizens that would, somehow, be out of the question.

I also would like to just quickly respond, Representative Clayton, to your question about entrepreneurial government. We think entrepreneurial government is terrific, but it has to look at both sides of the equation, not just the revenue side. Charging fees to be entrepreneurial is fine, if you look at the expense side, and you really run the thing as an entrepreneur would. Then, I think the whole equation becomes different.

Ms. CLAYTON. Fine.

Mr. BENNISON. If I could, I would like to add to that as well. The Independent Laboratory is another group that is a member of the BCFC. That is one of the big problems they have now. The universities are stepping in, and they are offering to do all these commercial lab tests and collect fees for the lab department. Some universities are utilizing their labs to even getting into the real estate area and now perform feasibility studies for local real estate companies. So, how does the local independent engineering company

compete with this? Also, the same thing with the laboratories. How do they compete? I mean, it is very tough to draw that fine line.

I realize universities need funding, too, as we pointed out in our testimony, but there comes a point where you just have to draw the line because if you don't, then there is no end to the businesses they can get into. The question then welcomes, how do you control that? What taxes should they pay?

Ms. CLAYTON. Where would you recommend we draw the line in terms of universities doing new technology and research? What makes that definable in terms of not transgressing into your area?

Mr. BENNISON. Well, I think, as David pointed out, if the service can be provided in the community by other businesses, then, that is the way it should go. As far as pure research and development, that is something else, because you are not charging a fee for that. But, as far as a service, as I pointed out, the feasibility study for real estate, things like that, as long as there are businesses that can do that in the community, I don't think that the university should engage in the activity as a commercial business.

Chairman BILBRAY. Mr. Wight.

Mr. WIGHT. Thank you. I think you are looking for tests to apply, and some parameters to be set. I would think one of the tests to determine if a balance exists would be if there is a long-term cost to the consumer, and then, is it reasonable to the consumer and taxpayer?

For example, it seems like almost every agency has a printing company somewhere. That has nothing to do with our business, but I, as a former Government employee in a county, saw them set up a printing department because someone said, "We can do it for less." Short term, it probably was less for that one project, but after 30 years and with nothing else to do, they were still on the payroll. I think the long-term costs, if you apply that test as a consumer and as a long-term taxpayer, there is maybe another balance or line to be drawn. It just seems to me that today it may work, but what are those total costs over the long period of time. What are those costs going to add up to the taxpayer?

Ms. CLAYTON. I did not quite fully understand how you distinguish if my alumni group wanted to have a trip abroad, and they were going to try to derive some revenue from it, is that unacceptable? Is that a fundraising activity that is permissible without violating your——

Mr. SANTINI. Under the definition provided on page one of what NTA considered to be unfair competition, it would be unacceptable, if that university or college attempted to conduct that tour business with the alumni office without employing the services or assistance of either a travel agent or a tour operator to conduct that tour.

Ms. CLAYTON. I see.

Mr. SANTINI. The reasoning that underpins that conclusion is that the travel agent or the tour operator will be paying taxes on the profit that they derive from that particular tour, and, at the same time, providing a very important service, or, at least, recreational opportunity, for that university. I think you can borrow on that experience and make it applicable to the units of local govern-

ment with which you are familiar if they elect to get into the travel and tourism business.

They, too, I think in fairness, as defined by our definition of unfair competition, should employ the services of a tour operator or travel agent to conduct that business on behalf of the local parks and recreation department, for example. In addition to fairness, I would suggest that there are other compelling and cogent reasons.

Second, the liability potential is enormous on some of these worldwide trips and tours. If one motor coach goes over one cliff, the city could find itself in lawsuits and bankruptcy for an extended period of time.

Third, we believe that the professional is much better able to run a good trip tour experience. Those who are doing it part time are doing it as an adjunct to the principal responsibility of that unit of local government or that university.

We believe that most universities and colleges today, I will say in conclusion, have found that to be true and are now using travel agents or tour operators.

Ms. CLAYTON. Thank you, Mr. Chairman.

Chairman BILBRAY. OK. I think that in fairness to the next panel, that we will have to conclude this panel now. Thank you very much. You have been very enlightening. I think that you have certainly made us think a lot about this problem and where to go from it. I think you have some enthusiasm from this subcommittee, as you probably have ascertained by the questions. So, we will certainly be working on it, and we will certainly be waiting to hear from the Government panelists who will be coming in a few weeks, as you will probably be waiting to hear what they have to say. So, we will apprise you as to what day they will be testifying in case you want to send representatives to listen to them.

Thank you, again, gentlemen for coming. We would like to call the next panel.

Mr. SANTINI. Thank you, Mr. Chairman.

Chairman BILBRAY. Thank you, Mr. Santini. This panel consists of four witnesses. Mr. John Imler, director of Government Affairs, California Travel and Parks Association; Mr. Everett Lovell, Aquia Pines Campground in Arlington, Virginia; Mr. Robert Buesing, president of East Coast Touring Co. in Eastern Pennsylvania; and Doc Milner, Capitol Tours, Inc. from Springfield, Illinois.

We will start with Mr. Imler. I have noticed that some of your testimony is quite lengthy. Please summarize this. The entire testimony of all four witnesses will be entered into the record in its entirety, if there is no objection.

Mr. Imler.

TESTIMONY OF JOHN F. IMLER, DIRECTOR OF GOVERNMENT AFFAIRS, CALIFORNIA TRAVEL PARKS ASSOCIATION

Mr. IMLER. Thank you, Chairman Bilbray, and members of the committee. I, like my predecessors on this panel, appreciate your interest in this subject.

My name is John Imler. As director of Government Affairs for the California Travel Parks Association, my comments today will

address unfair competition from various Government agencies on behalf of my own association and its members, as well as the National Association of RV Parks and Campgrounds and its members.

I am a former campground owner and have been involved with both the California and the national association since 1975. The RV park and campground industry is, perhaps, unique when compared with other private businesses in that a Government agency is nearly always its largest and major competitor. Our industry faces competition from all levels of Government—in the Federal level, from agencies such as the National Park Service, U.S. Forestry Service, Bureau of Land Management, and the Army Corps of Engineers; on the State level, mostly from each State's Department of Parks and Recreation. On the local level, we face competition from city and county parks departments, fairgrounds, and various water districts within the counties.

We not only face competition from Government agencies, but that competition is often unfair to the private operators in many ways. In my written testimony that I have submitted to the committee earlier, I have discussed eight specific areas which I believe to be the cause of unfair competition. Today, I would like to call your attention to the eighth item on that list, the item of free camping.

Private park operators cannot comprehend how Government facilities can provide free camping. In today's constraints of Government budgets in every level, that they are providing taxpayers subsidized free camping is incomprehensible to us. Just to give you a couple of examples.

East of Fresno, California, in the Sierra foothills, lies Pine Flat Lake. In Pine Flat Lake is a Corps of Engineer's facility and one of our members, Lake Ridge Camping and Boating Resort. Mr. Martin Korndobbler, owner of Lake Ridge, has contacted our office several times relative to the free camping provided by the Corps. He indicates that the Corps facilities are supposedly closed at times when his park was void of campers, the Corps' campground has up to 14 camping parties. He also indicates that on several occasions, campers have actually made reservations with his park only to arrive and learn that they can camp free at the Corps' park, ask for a refund, move out of his park, and move over to the Corps' campground.

We have corresponded with the Corps, who have said that their policy is not to collect fees in the low season due to low occupancy. Our question is, then, why is the campground not totally and legitimately closed? People are still using the facilities within that campground.

The second is one which really has caused a lot of problems in the State of California. It is an area called Freshwater Lagoon and lies along Highway 101 in Northern California, just south of the town of Orick and south of the Redwood National Parks Visitors' Center. This parcel has been owned by the California Department of Transportation since 1949. It will eventually provide them with the right of way for the expansion of Highway 101 into a four lane divided highway. The parcel lies next to the Pacific Ocean on the west side of the current roadway, and is approximately 100 feet wide and nearly 2 miles long.

Over a period of time, this area became a parking area for individuals wanting a temporary home or low priced vacation spot. Estimates of as high as 400 trailers, pick-up campers, school buses, and autos have lined that roadway nightly, creating traffic hazards.

After years of complaints from our association, citizens, and some of the area businesses, CALTRANS decided to do something about it. But what did they do? In 1989, the area was leased to the National Park Service for the unbelievable price of $1 per year. Now, the area has been legitimatized and operates as a free campground of the National Park Service. It now has fire rings, picnic tables, chemical toilets, trash receptacles, park rangers on horseback, interpretative programs, and a special tenting area. The homeless no longer populate the area. It now appeals to the legitimate camper with every type of camping equipment, including motor homes costing hundreds of thousands of dollars.

In addition, campers traveling along 101 in the area of Fresh Water Lagoon are advised on special highway signs to tune their radios to certain frequencies to receive road information. Once tuned to that frequency, they hear the good news that the National Park Service has a free campground available to them at the Redwoods National Park Fresh Water Lagoon Campground.

The Park Service's own reports indicate that they have stolen over 41,000 camper nights from private enterprise in just 2½ years. That report also notes that the total is even probably higher when it notes that many campers were missed because they left early before we completed our census. The report further indicates that while there are donations requested, that less than $13,000 has been taken in, while the cost of the operation in only 3 years has been over $200,000 to the Park Service. It hardly makes sense to us.

What effect has this had on our parks? We understand that this year, 1993, five of the parks in that area will not open because of the effect of this free camping offered by the National Park Service. The rest of the parks are saying that they are down 30 to 50 percent on overnight traffic in the Summer season. There are 2,500 sites within 20 miles of the National Park Service's free campsite. We can see no reason why this should continue to be allowed, particularly when the income is less than 7 percent of the cost of the operation.

Our parks are asking for your assistance because this is a national problem. We have other problems that are State problems and county problems, but these are national problems. They ask for your assistance in saving their business investments, their life savings, and, in some cases, their very lives. I would like to offer you four specific things we would like to see done to help these areas and help us with these particular problems in the State of California: First, introduce or pass legislation that would mandate that Government agencies not develop camping or RV spaces in any area until a legitimate demand for such spaces exist which is not being met by private enterprise; second, introduce and pass legislation which would require all Government agencies to survey all camping facilities regarding pricing, and to establish pricing that directly reflects all costs of the operation, the value of land, the im-

provement, and that is competitive with private enterprise in the area; third, introduce and pass legislation that would require that all facilities of Government agencies, when closed, be totally closed, and posted that any person using such facilities is subject to citation and fine; fourth, require that prior to the onsite development of any camping facilities at any currently undeveloped or future acquisition by any Government agency, that agency first encourage and assist in the development of private camping facilities on the perimeter of such Government-owned property. This step would encourage the preservation of historical and ecological sensitive areas from commercial development.

I thank you for this opportunity to speak to you.

[Mr. Imler's statement, with attachment, may be found in the appendix.]

Chairman BILBRAY. At this time, we will go to Mr. Lovell.

TESTIMONY OF S. EVERETT LOVELL, JR., OWNER, AQUIA PINES CAMPGROUND, AND CHAIRMAN OF THE BOARD, VIRGINIA CAMPGROUND ASSOCIATION

Mr. LOVELL. Thank you, Mr. Chairman, and good afternoon. I am the owner of Aquia Pines Campground, which is actually located just south of Washington, DC in Stafford, Virginia. You mentioned that I was from Arlington. I happen to personally reside in Arlington, but the campground is in Stafford, Virginia. Thank you, Chairman Bilbray, and Ranking Republican Member Baker, for this opportunity to express my views as a small business owner.

I am representative of the 200 plus private rural campgrounds in Virginia and thousands of rural campgrounds nationwide. I will be brief, I promise, and please accept my written notes for the record.

Chairman BILBRAY. Yes; they will be put in the record in their entirety.

Mr. LOVELL. Two specific areas that I would like to touch upon. One is the proposed construction of camping facilities at Fort Belvoir, Virginia by the U.S. Army, and the other is the overnight parking in the interstate highway rest areas. I would like to touch upon the rest areas first.

In Virginia, Federal funds paid to build all the rest areas with the exception of one. Besides serving their intended function, the rest areas are now used for a variety of illegal activity. Illegal overnight parking costs Aquia Pines approximately $80,000 a year in lost revenue. This can be directly translated into lost jobs and lost tax revenue. In addition, most of this revenue would be in my slower season, which makes it even more painful. Currently, I don't keep high school students into the late Fall, or don't hire them back as early in the Spring as I would like to, primarily because of lack of revenue.

I don't mind travelers relaxing in the rest area. The current limit is 2 hours. I, certainly, don't even mind them staying 3 and 4 hours. But, when we have campers that pull in the rest areas, put down their leveling jacks, blocks, start their generators, put down the screws on the tongues of their trailers, they are there for the duration of the night. That is not the intention of the rest area.

That is, definitely, overnight camping. It is costing small business dearly.

Concerning the proposed construction of a campground at Fort Belvoir, this is a campground, marina, restaurant, and country club type complex. In my notes here, you will see a letter from a Colonel McLeurin to Herb Bateman. I have written Congressman Bateman asking for his assistance. This was the Army's response. In my notes, I refute most of the Army's, or all of the Army's responses, as to why they think they need the campground, and why they need to build the campground.

No one disputes that a secondary mission of a military facility is to provide recreation for their personnel, however. To accomplish this mission, clearly, the Army doesn't need to construct, own, and operate the facilities which duplicate the services offered by the private sector. Many campgrounds in both Virginia and Maryland serve the local residents, retirees, and travelers visiting the Metropolitan DC area.

As an alternative to building facilities, I think the military should explore other cost-efficient methods. I would propose the Department of the Army issue vouchers for use in local and private campgrounds, rather than actually build their own facilities. This would give their personnel a choice. They could go to a bayside campground. They could go out into the mountains. They could choose a rustic campground. They could choose a well-developed campground, much more than what the Army could actually provide itself.

Army officials should strive to bring the lowest cost camping possible to military personnel with no job loss or tax revenue loss to the local economy. They should not seek to remove low-cost, private sector jobs and replace them with higher cost Federal jobs, given the limited demand for the campground or campsite market. It is wrong for the Federal Government to continue planning these facilities, while ignoring the fact that these facilities are not currently needed, and that the construction will negatively impact existing small business. With the continued downsizing of the U.S. military, there will be even less demand in the future for these nonessential facilities, such as the outdoor recreation.

In closing, I would appreciate any help you, your staff, or the President, could offer to stop this proposed construction of a campground at Fort Belvoir. The Army can offer very low cost, or even free camping, to its personnel by issuing vouchers.

[Mr. Lovell's statement, with attachments, may be found in the appendix.]

Chairman BILBRAY. Thank you. Mr. Buesing.

TESTIMONY OF ROBERT T. BUESING, PRESIDENT, EAST COAST TOURING CO.

Mr. BUESING. I would like to take this opportunity to thank Chairman Bilbray and the rest of the members of the committee for allowing me to share with you my real life experience about the devastating effect of unfair competition in my small business.

We all talked a lot today about small business. My definition of small business, as it comes to my job, is I will be the same person

that goes to the bank and deposits $100,000 and, on Friday, takes the garbage out to the dumpster. That is how a small businessman in my capacity works.

In order to understand my story, you must first understand what East Coast Touring Co. does. We are a tour operator that actively engages in the business of organizing, selling, and operating escort tours on a for-profit basis. In layman terms, we sell an entire vacation package, including transportation, hotel, attractions, and most meals, into one exclusive package.

East Coast Touring Co. sells 95 percent of our tours directly to senior citizen clubs, school groups, and many others. East Coast Touring Co. is truly a small business success story. What started out in 1981 as just a conversation over dinner has turned into a $2-million-a-year company, employing approximately 14 full time employees and part time. In 1992, my company, East Coast Touring Co., paid $46,617 in Federal, State, and local taxes.

I also have become very aware of unfair competition due to my appointment on the National Tour Association Government Relations Committee. As you will be aware, the National Tour Association is an organization of companies that plan and operate quality tours throughout North America. Presently, NTA is closing in on 600 tour operator members.

Over the last few years, the cost of doing business in the wake of recession, increased Government regulation, and new taxes, certainly affected many small businesses. I am but one of a nation of small business tour operators who have been invaded and disrupted by so-called tax-exempt organizations that have decided to go into competition with my touring company.

We realize that the national economy, global markets, and inflation are not within your immediate control. However, you can help me with these invaders by tightening the many loop holes that they operate within. Left unchecked, these tax-exempt organizations will slowly choke out the many small companies like mine.

Mr. Chairman, today, I would just like to highlight three of the examples that I do have on page two.

Example one, and probably the fastest growing, the group leader. Definition of a group leader is a person who, for a club organization, will make all decisions regarding where that group organization will travel. He or she can now sit at home and, by using 800 numbers, effectively make all arrangements for their group's travel. In other words, they operate a tour service right off of their kitchen table. By doing so, they can avoid all taxes, regulations, insurance, and other operational expenses enabling them to compete unfairly with the for-profit taxpaying tour operator. This, by far, is the fastest and largest growing segment of unkempt fair competition as it pertains to my company. We need your help in order to keep the many small tour companies profitable.

I set forth in these next two examples, for this committee, demonstration of what can happen when tax-supported public entities decide to go into the tour industry in direct competition with me. In our area, we have many county- and city-run senior citizen centers that are operated with county and State tax dollars. These centers are very important to many senior citizens who look for-

ward to spending time and enjoying the many activities that these centers offer for them. One of these activities is traveling.

However, many senior citizen directors, who are employed by the county or city, have taken it upon themselves to organize, sell, and operate day and night tours themselves, instead of purchasing the tour from a for-profit small business. I will go in detail in example three why this practice by tax-exempt organizations is so devastating to my business.

Aside from the previous two examples that I first illustrated, there is one more that even exists within our own industry. Due to the lack of direction by Federal, State, and local governments, we at NTA have started a dialog between our members. We do, however, believe that more direction by our elected officials is desperately needed to help the small business.

Example 3, in March 1993, one of my group leaders came to me with a day tour that she wanted to do in a specific region. She informed me that she could book this tour directly through the regional visitor's bureau. After some phone calls, imagine my surprise to find out that this visitor bureau, which is a nonprofit, was operating a full-service touring company. Their price for the tour to this customer was $31. Their price to me, if I purchased it from them, was also $31.

Because I do not own my own buses and make no money from the transportation end of that tour, when adding my profit to the package to cover my insurance costs, et cetera, I cannot sell that package to her for the same price that she could do it for herself. Subsequently, the booking was for 92 people, and my company lost the sale, and it booked with the regular tourist promotion agency.

You may wonder why I consider this unfair competition. After all, tourism promotional agencies are there to bring tourism into their area, are they not? They have an obligation to increase revenues for their members, don't they? Yes; they do, but they should not be allowed to hide behind the protection of their tax-exempt status to compete against a for-profit, small business that can provide the same product with better service and protection for the consumer.

Listed below are some facts concerning this example. This visitor's bureau in question receives $78,000 in State funds in 1992. Their nonprofit status allows lower postage and exception of most corporate, State, and Federal taxes. From the above funds, the following is paid for with my tax dollars: Their 800 phone number; all marketing brochures printed; and all mailing and postage paid for. All trade shows that they go and represent their products at alongside of a booth with me is paid for by the State funds. Most important for the consumer, they do not have to meet the stringent insurance, bonding, and regulatory requirements that a for-profit, touring company does.

After further review, and I will just highlight this quickly, that visitor's bureau in my State operated 104 tours in 1992. It had 4,160 passengers. The total revenue brought in was $128,000, which was nontaxable revenue, which cost the Federal Government $1,843 in tax revenue, the State government, and the Federal Government, $1,600. If you times that above figure by the 10 tourist promotion agencies in my State alone doing this, you can see that

it is certainly a loss for both our Federal, State, and local governments in tax revenue.

In closing, Mr. Chairman, the numbers of small businesses that are closing each year is increasing. It is the small businesses that make up the base of the Nation's economy. My American dream has been to be successful in operating my small business. Yes; to date, I have been successful. What the future holds for me is uncertain. The number of 1-day tours that I run per year is down 60 percent from 10 years ago. The number of 2- and 3-day tours that I run per year is down 30 percent. These figures are increasing each year.

Once again, I thank you, Chairman Bilbray, and the rest of the members of the committee, for hearing my testimony today. I certainly hope that something can be alleviated in the years to come.

Thank you.

[Mr. Buesing's statement may be found in the appendix.]

Chairman BILBRAY. Thank you, Mr. Buesing. Mr. Milner, my colleague is going to chair for about 2 minutes, but if you start your testimony, I will be right back.

TESTIMONY OF S. BURKETT "DOC" MILNER, FIRST VICE PRESIDENT, NATIONAL TOUR ASSOCIATION

Mr. MILNER. Mr. Chairman and members of the subcommittee, my name is Doc Milner, and I am presenting testimony to you today in my capacity as the first vice president of the National Tour Association and as the vice president of Capitol Tours in Springfield, Illinois. I wish to express my thanks to the subcommittee for agreeing to hold this hearing on an issue that has consistently been identified by our members as the number one Government issue facing our industry.

Primarily, the typical tour company is a small and often family-owned business. The company provides its clients with a complete vacation package, including transportation, accommodations, some or all meals, sightseeing, and a professional escort, all for one price. Our tour patrons consist primarily of senior citizens on a fixed income who cannot afford, or are not physically able, to travel by themselves.

For each tour package that is sold, the for-profit tour operator, like all U.S. for-profit businesses, must pay taxes on its revenues and meet a multitude of Government regulations. When marketing these packages, the for-profit tour operator relies most heavily on repeat business, word of mouth recommendations, and direct mail. I point this out because it is the tax-exempt organizations' exemption from paying taxes and ability to use Government subsidized postal rates that places tour companies like mine at such an unfair advantage when trying to compete directly with tax-exempt organizations.

The National Tour Association defines unfair competition as resulting when a tax-exempt organization, a not-for-profit group, or a Government subsidized agency, sells goods and services on a frequent and ongoing basis, using special privileges. The organization does not use for-profit intermediaries to provide its goods and serv-

ices. Rather, it sells similar products to compete directly with private, for-profit businesses.

The main privileges, as far as our industry is concerned, are exemption from taxes and reduced postal rates. As a tour operator with a base of operation in the Midwest, I am painfully aware of unfair competition. My biggest competitors are not other tour companies, but churches, museums, and senior citizen organizations operating their own tours as nonprofit entities. As a matter of fact, one of these churches operates more tours than most tour companies in the State of Illinois. This church has its own motor coaches that were purchased by tax-deductible donations from members while operating their tours and using reduced postage rates.

Using these examples, it is easy to see why for-profit tour operators cannot compete with tax-exempt organizations that offer the same services. First and foremost, I must pay taxes on my services. These taxes must be passed on to tour patrons, resulting in higher priced tours. Second, to market my services, I must buy ads in local newspapers. These costs also have to be passed on to my tour patrons. Finally, I rely heavily on direct mail for marketing, and must pay for-profit postage rates, substantially higher than those of the tax-exempt organizations. All these costs must be built into the final cost of my tour.

Now, as you know, a lot of tour patrons are senior citizens and students. It should come as no surprise to you that these tour patrons are extremely cost-conscious. Even a dollar difference in a tour price can be the difference between booking a tour with a company that is operating for a for-profit making entity than a company that is operating for a not-for-profit entity. The irony is that for every dollar in business that flows through a tax-exempt organization, little or no revenue is returned to the Government in the form of taxes. Meanwhile, for-profit tour companies go out of business frequently due to their inability to compete with tax-exempt organizations.

In conclusion, I will reiterate that the issue of unfair competition, practiced by tax-exempt organizations, is depriving public coffers of billions of dollars in tax revenues, while putting for-profit, tax-revenue sources, like tour companies, out of business. Unless changes are made, tax-exempt organizations will continue to offer their commercial services, generating billions of dollars in tax-free profits.

Members of this subcommittee, we think it is time that we change the rules and protect small business. Again, thanks to the subcommittee for their willingness to hold this hearing on this very important issue to our industry.

Thank you.

[Mr. Milner's statement may be found in the appendix.]

Chairman BILBRAY. Thank you very much, Mr. Milner. I had to slip out because we had a young woman who is the Small Businesswoman of the Year, and I had to go out and shake her hand and take a picture with her. I thought that anybody who makes Small Businessperson of the Year certainly deserves a little bit of individual attention in this economic climate, especially.

Mr. Lovell, in your discussion of what is going on at Fort Belvoir, I presume that is an MWR panel funding. Are you familiar with the Morale, Welfare, and Recreational Panel?

Mr. LOVELL. No, sir; I am not. In talking with the people at Fort Belvoir, they said it was not appropriated funding.

Chairman BILBRAY. That is correct. A number of years ago, probably before you and I were born, the military started a fund in which they probably put some original seed money in, and they loaned that out to enlisted men's and officer's clubs. They have to have an economic statement created to know that they can pay it back. What happens is that the MWR fund, which is administered by Congress, but it is not our money, then loans the money to that particular entity, whether that is an officer's club, an enlisted men's club, a golf course on a military base, or whatever it may be, and they have to pay it back at a guaranteed low-interest rate which the fund sets up. I presume that the project you are talking about has been funded by the MWR panel.

Now, they are supposed to be very limited as to whom are allowed to use that. It is supposed to be the military personnel and their families, and, in certain cases, retirees can use overflow time on the facility. But civilians off the facility are not supposed to be able to use those facilities. Is that your understanding of this project, or not?

Mr. LOVELL. When speaking to the Fort Belvoir personnel, they did say that they already hosted, even before they built their campground, I think it was a 156-unit camping club of retired military people. That is a lot of money out of the public sector.

Chairman BILBRAY. A retired military club you are talking about, but you see, what I am saying is that retirees are allowed to use MWR facilities, but they must be retirees. They can't be just people who were in the military for 2 or 3 years. I was in the military and many of you were in the military, but I am not a military retiree.

We will look into that project, but I imagine that project has already been funded by the MWR panel, and is probably going ahead at this point. But we will check it out at this point. But it should not be in competition with, unless the soldiers, themselves, are using your facilities right now and would not be using them. In most cases, the problems they found with the military is that the enlisted men, especially, have such limited income. That is why they create golf courses on military bases, tennis courts, and enlisted men's clubs where they can buy beer at 15 or 20 cents. When I was in there, it was like 10 cents. I won't tell you how long ago that was.

[Laughter.]

Chairman BILBRAY. Only in Las Vegas can you still get beer at 10 cents. If anybody wants to come there, I will help make reservations for you at any time through a profit-making entity.

[Laughter.]

Chairman BILBRAY. I appreciate your conversation. I know we have similar problems on some of our bases where they are building hotels on the bases, and so forth, to handle certain families. A lot of the businesses around there are really upset. But, I understand that this is a real problem.

Mr. Buesing, I was curious in this case, when you are dealing with a State entity, and I presume the visitor's bureau is a State entity, but they are offering the buses, too, so they must contract with a profit group for the buses, do they not?

Mr. BUESING. No; they are not offering the buses. How it works is they have a visitor's bureau that is there to promote this region. Well, from just sending out booklets and mail promoting this region, and trying to get some interest for these group leaders to bring their groups in, they have taken it one step further. They sell the package.

They go to these shows where these group leaders come to pick up new ideas of travel. They will put together the entire package, including attractions, lunch, and boat rides, or whatever it is, and sell it in one little neat package, so the group leader doesn't have to make those three or four phone calls. They will put it together, and then sell it to the group leader, and the group leader goes and gets a bus on her own or on his own.

Not owning my own buses, I do not make the money in transportation, so I sell the exact same type of product, but going to many destinations throughout the State of Pennsylvania and all over the world. So, when a group, when a TPA, tours and promotion agency, makes it this easy for a group leader using my tax dollars that I paid to the State, they can bypass me and save the profit that I would make, and go directly to the——

Chairman BILBRAY. But, in a sense, the visitor's center does not pay taxes, but the people receiving, they pay for the lunches, or the accommodations, or the boat rides, or whatever it is. Those are not for nonprofit.

Mr. BUESING. They pay taxes. But they would not be able to do that and offer that package to the visitor's bureau at $31, as an example, if they had to pay for their own 800 number, if they had to pay for the brochures that they were marketing, or if they had to pay for the salary of that person working in that building, as well as all the marketing that goes into it. They could not sell that for $31. They would have to sell it maybe in the same line that I would. That is why I can't compete with them. It is getting to be a problem and not only in my State. In my State, it is called the Matching Fund Program. They are looking at that right now to see if those State funds can be used in such a business.

Chairman BILBRAY. Mrs. Clayton.

Mrs. CLAYTON. I guess it was Mr. Lovell who raised something of the same issue in terms of overnight parking at the rest facilities. My State has rest facilities. North Carolina joins Virginia, and I guess I just hadn't given much thought to the entrepreneurial side of it. I mean, if a truck goes in there to rest all night, there is no charge, right?

Mr. LOVELL. I am not that familiar with the trucks, but I know that ICC regulations——

Mrs. CLAYTON. Let's say a car. If a car goes to your rest station, and is tired, and needs to rest 6 hours, there is not a charge for that, is there?

Mr. LOVELL. There is not a charge, but that is illegal in the State of Virginia.

Mrs. CLAYTON. Oh, is it?

Mr. LOVELL. Yes, ma'am.

Mrs. CLAYTON. What is your requirement?

Mr. LOVELL. The State of Virginia says that anybody who stays over 2 hours is violating the law, because there is a 2-hour parking limit. I, personally, don't care if they stay 3 or 4 hours, but I do have a problem when they stay there all night.

Chairman BILBRAY. Did you not say, though, that they are changing that law? Is that what is going on now? I got the same conclusion you did, that they are allowing overnight, but, maybe, you were just saying that hypothetically.

Mr. LOVELL. They don't allow it. It happens.

Chairman BILBRAY. OK.

Mr. LOVELL. It is an ongoing problem.

Chairman BILBRAY. So, it is not legal, but people are doing it, and no one is enforcing the staying overnight.

Mr. LOVELL. That is correct, and also, as I say in my notes, the Virginia Campground Association has done surveys and documented how many people are there for maybe an 11-day period or something like that. We have seen the same units back there consecutive nights.

Chairman BILBRAY. Mr. Lovell, I understand that problem, but how does that relate to a Federal problem? That is more a State problem to enforce their laws, is it not?

Mr. LOVELL. They were federally funded.

Chairman BILBRAY. Federally funded?

Mr. LOVELL. The rest areas.

Chairman BILBRAY. The rest areas. Yes; I mean, most of the highways are federally funded, too, but once we fund them, we turn them over to the States. It becomes a State highway, or it becomes an interstate highway that we produce. In my State, 95 percent of the funds are Federal, and 5 percent are local because we have so much public lands out there. But, once they are built, they are maintained, supervised, and patrolled by the State, not by Federal police.

Mr. LOVELL. Yes, sir.

Chairman BILBRAY. In this case, certainly, I agree with you that it should be enforced. If those are the rules, they should be enforced, but I think that the organization should put pressure on the State's highway patrol, or the local Alexandria City police, or Fairfax County police, or whoever it is, to enforce the rules. Undoubtedly, they probably feel that they have other things to do, and they are not going to be bothered with stopping and kicking people out of campgrounds.

But I am not sure, on our level, what we can do about that very much. I mean, even if we put a Federal regulation in—for instance, we have one that says that they have to conform to the 55-mile-an-hour speed limit, except in some areas, it can be 65. But it is not Federal police who enforce that law. We mandate that the States enforce that law because we do not have Federal highway patrol cars. It is not part of our jurisdiction. If you say it too loud, we are liable to end up with Federal police, and that is the last thing we want.

[Laughter.]

Mrs. CLAYTON. I wanted to know about the leader concept. How do we distinguish between that and what we call the cottage industry? Is this unregulated? There is a whole new highway of technology where individuals stay at home and mom and pop do things with computers.

Mr. BUESING. In the State of Pennsylvania, since the deregulation of travel industry and the motor coach industry, you must have what is known as a PUC license to execute tours within our State. However, when you go interstate, if she is running a tour from Eastern Pennsylvania to Atlantic City, there is no regulation that is required for her or him, whichever the case may be. Because of the 800 numbers today through hotels, CVB's, and tourist promotion agencies, they are able to do just that. In many cases, the money that is being derived through their club, or, in some cases, these group leaders are doing it for themselves, never sees the tax dollar. I know that is a tough one to enforce.

Mrs. CLAYTON. What do you suggest? Are you suggesting that because of the new technology 800, that monitoring is necessary?

Mr. BUESING. No; not at all. I think what needs to be done, in my opinion, is one of the things that we have done with the colleges, as far as the alumnus who were operating tour departments amongst the college campuses. If we can get the Internal Revenue Service also to look at these other entities, even though smaller church groups, AARP, clubs, and I know that is a very touchy situation on your part, but let them know that they are acting in a for-profit company.

I have many group leaders that do tours with me. I win some and lose some. If I am competing against Doc, he might win one, and I might win one, but, at least, it is a for-profit company. But when someone is sitting at home doing it all themselves, and does not pay the insurance bill that I do to insure those people against accidents, illnesses, et cetera, and the regulations, I can't compete against that person working at home. Subsequently, they can put that package together and sell it to their people cheaper than I can, add a few dollars, and either make money for the club, or make money for themselves. In that case, I think if they are making money for the club, that is competing against me and should be taxable income.

Mrs. CLAYTON. Mr. Chairman, does the unrelated business of nonprofit address this issue?

Chairman BILBRAY. It is supposed to be taxable. Is that what you are getting at?

Mrs. CLAYTON. Yes; if a church is doing tours.

Chairman BILBRAY. I think what it came down to, for instance, some of the Christian Brothers were making wine out in California for years, and I think they lost their tax exemption. They did for their monasteries and things like that. But the wine they sell, they have to pay the taxes on it. It came down that many church groups and charities had vast holdings way beyond their particular regulated church business. It becomes a question, at what point do these properties require taxes and what is unrelated business?

What I look at, Ms. Clayton, in this particular regard, is if you were a director of a senior citizen's complex in Allentown, Pennsylvania, and you called up and found out you had 30 members of

your group wanting to come someplace else in Pennsylvania for the weekend, is that unrelated business. On the other hand, if you, as a director there, decided, "Hey, this is a pretty good business" and started making the bookings for every other senior citizen's center in the area, certainly, you have stepped beyond the line of what is related to your particular group. I think that is where probably the problem area is.

I don't think Mr. Buesing is saying that if I want to call up for the Small Business Committee and book a reservation for the committee to go to your town, and set up the room, and set up the transportation, or had one of my staff doing it, that he is competing against small business or the travel agency down the street, if we want to do it direct. On the other hand, if my aid decides he wants to do it for everybody in Congress now, and in some way or another, get a commission or something on it, then, of course, he has stepped beyond the line. But are you saying that if he wants to, this committee wants to go to your hometown and have a hearing, that he is competing with you if he calls up and makes it direct and doesn't call a travel agency or something like that?

Mr. BUESING. In Pennsylvania, the way the PUC is drafted is if they go outside of their group. In other words, this is the case in most of our areas with these group leaders that if they cannot fill the entire coach themselves, they then, put it in the newspaper, and they go public with it. When they compete, no one can stop anybody from making a reservation for a group of people if they want to go somewhere. But when they get into making the money on it, or going public with it, like so many of them are, that is when——

Chairman BILBRAY. There are two different points here. One is making money on it and one is going public with it. If I want to fill up my bus, and I have 10 open seats, and I provide those 10 open seats for exactly what we are paying for it, there is no profit, so there would be no tax paid to the Federal Government, even it they had to declare it because it was a break even proposition. On the other hand, if they charged $40.00 a seat for that $31.00 and made $90.00, then there was, certainly, a $90.00 profit. Are we talking about two different things?

Mr. BUESING. But you also mentioned there that you had 10 empty seats and you went public with it. I think the part of when you go public——

Chairman BILBRAY. But how do you tax that if they don't make a profit? You are saying, "Forbid them to do that."

Mr. BUESING. No; I am saying, when they go public with it and compete against me——

Chairman BILBRAY. They lose their nontax——

Mr. BUESING. They should not be able to do the mailings which are, certainly, more economical than me, and the other things that come along with being that tax-exempt organization.

Chairman BILBRAY. Well, two things are going on right now for your own benefit. The Post Office, of course, is looking very much at raising the nonprofit status and the cost of mailing nonprofit mailings. But, second, we certainly are going to question, when we have our Governmental witnesses, where they step beyond and mail beyond their appropriate authority. That should be looked at.

I agree with you that they should not be able to use tax-subsidized, in this case, post office subsidized because taxpayers pay it now by paying their post office. Third class mail and first class end up paying for the nonprofits to mail. We will certainly look at that when we hear additional testimony.

Ms. Clayton, do you have any more questions?

Mrs. CLAYTON. No; I do not. Thank you.

Chairman BILBRAY. Are there any last points you want to make at this time? I am telling you, you have presented a lot for us to think about. I wish most of the committee members were here to hear it today, but we will make a report of this committee hearing available to all the minority members and majority members of the committee.

Mr. BUESING. Just one thing I would like to add, Mr. Chairman, and I know Mr. Santini has mentioned this, when you go through this Philadelphia Inquirer paper, you will be amazed at just exactly what you were speaking of, the taxes and also, the proliferation of the groups mailing. I just hope that everybody gets to see it.

Chairman BILBRAY. Well, I will tell you one thing I believe, and I found this over the years. I think it is too easy to get a nonprofit status anymore with the IRS. It can take you a long time to get it. Sometimes, it can take you up to 2 years, but it is not hard to get. It is just long to get. It used to be, when Mr. Santini and I used to practice law, you could get it in about 2 months. Now, it takes a couple of years, sometimes, to get it. I know because some of them who are legitimate come to me because they have been sitting back for a year or two waiting trying to get it from the IRS, the classification.

But we will look at it very carefully. Mr. Lovell, I will bring that up. Solomon Ortiz is the new chairman of the MWR panel, and I will discuss your situation with him, too, at the present time. But, I have a feeling, if it has gone to the point where you are talking about, that it has probably already been approved, and funded, and it is already actually being built at this point. Maybe the physical grounds has not been done, but I bet you the plans have been drawn and the moneys have been allocated from the MWR panel.

Mr. LOVELL. As of this fall, they were still in the planning stage. I don't know at what stage they are at this point.

Chairman BILBRAY. Thank you, gentlemen. I am sorry you had to wait so late to testify, but this was important testimony to our committee and something that we are going to follow up on. Again, we will notify you when the governmental agencies will be testifying so that you can have representatives here to hear their testimony, if you so desire.

The hearing is concluded.

[Whereupon, at 4:54 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

APPENDIX

Opening Statement of the
Honorable James H. Bilbray
Chairman
Subcommittee on Procurement, Taxation, and Tourism
of the
Committee on Small Business

"Unfair competition from public sector entities
in the tourism industry and related industries."

It is my pleasure today to open the first formal hearing of the Subcommittee on Procurement, Taxation, and Tourism. I am particularly grateful that I will have assisting me in the ranking minority position my good friend Richard Baker. I look forward to working with him and his staff and to receiving his comments on the issues we will undertake.

Today, the subcommittee tackles the issue of unfair competition from the public sector in the tourism and related industries. Tourism is an industry that is dominated by small, often family owned operators. It is an industry that relies on the safeguards, protection, and benefits that government at all levels provides to small business. It is also an industry that is particularly sensitive if those protecting barriers fall.

I have recently become aware of a number of concerns regarding the unfair advantages that many public agencies and non-profit entities have in competition with private commercial entities. Today's hearing is meant to shed light on the issue and to assist this subcommittee and Congress in understanding the circumstances surrounding this issue and possible solutions.

Some issues of particular concern, and which I hope the witnesses will address, are apparent abuses of the unrelated business income tax (UBIT) by the non-profits and other entities. It appears, that with this competition a significant amount of tax revenue is being lost and abuses of the intent of non-profit status is being permeated.

In addition, I believe that it is essential that the plight of the small businesses affected by this situation be highlighted. The associations that are represented here today are made up mostly of small firms. If the government, its policies or its benefits are hurting the small businesses of this country, I believe that it is necessary that this subcommittee address those issues and find ways to rectify these mistakes.

Finally, this subcommittee wants to stress that it enters these and any other subsequent hearings with an open mind. Our goal is to rectify any problems or misunderstandings between the public and private sector, promote a dialogue that will reduce government expenses and waste and also assure the profitability and

stability of private industries. As a member of the Armed Services Committee, I am well aware of the continued shrinkage of the federal government and the desire to streamline federal services and if possible make these federal entities self sustaining. However, we must be careful to weigh these needs along with our duty to protect American small businesses and the economies that depend on them.

Opening Statement by

Congressman Richard H. Baker, Ranking Member

Subcommittee on Procurement, Taxation & Tourism

May 11, 1993 Hearing on "Unfair Competition from the Public Sector"

Mr. Chairman, let me begin by saying that I look forward to working with you as the Subcommittee meets for its first official hearing of the 103rd Congress. It is a privilege to associate myself with the Chairman from Las Vegas, and I am confident that the subcommittee will have a productive year.

I thank you in particular for the subject matter of today's hearing, and also for the participation of each of the panelists this afternoon. After reviewing the testimony of all of the participants, it is very clear that this hearing is a timely forum to consider the existing disadvantages that the private sector faces when it must compete with the public sector.

To the extent that the public sector actually disadvantages a competing private sector business in a particular locality, we are in effect, limiting potential federal tax revenues. While we have not yet had the opportunity to explore the other side of this issue, it is clear from today's participants that the public sector, in many cases, enjoys competitive advantages by not having to pay certain taxes (i.e., tax-exempt status, UBIT, business revenues, real

property taxes), being able to offer below market pricing, and being afforded the luxury of some public sector accommodations (i.e., low cost highway signs and 1-800 phone numbers). These facts serve only to increase our national debt and to intensify our mounting fiscal crisis.

I found the written testimony particularly insightful and timely as I work with local businesses and local governments to develop rural tourism opportunities in Central Louisiana. In fact, this subcommittee is scheduled to travel to Alexandria, Louisiana on June 25, 1993 for a field hearing to discuss how the federal government can streamline the procedures for supporting localities which are interested in developing rural tourism opportunities. I found the written comments particularly interesting in the context of one particular economic opportunity in Louisiana.

I am working with local businesses, out-of-state businesses, state agencies, elected state and local officials, and municipalities to enhance tourism opportunities at the Toledo Bend Reservoir. Toledo Bend is the 5th largest man made lake in the United States (the largest lake in the South). Its 186,000 acres stretch out for 79 miles and represent much of the border between Louisiana and Texas. The problems confronting Toledo Bend include poor road access, insufficient infrastructure, additional facilities for people seeking land-related recreation, and a genuine lack of hotel and motel rooms.

Opportunities for both the public and private sectors on Toledo Bend is limitless. This hearing provides valuable instruction on the roles of both public and private sector participation in tourism opportunities.

For these reasons, the testimony and comments this afternoon are particularly helpful and instructive for both the Subcommittee and my own Congressional District. I thank you again for your participation and I thank the Chairman for an insightful start for the Subcommittee.

STATEMENT

to the

Committee on Small Business
Subcommittee on Procurement, Taxation and Tourism
United States House of Representatives
Rayburn House Office Building

by

Honorable James D. Santini
Executive Committee
Travel and Tourism Government Affairs Council
Washington Representative, National Tour Association

May 11, 1993

Two Lafayette Centre, 1133 21st Street, NW, Washington, DC 20036, Tel: (202) 293-5407, Fax: (202) 293-3155

Mr. Chairman and members of the Committee, on behalf of the Travel and Tourism Government Affairs Council I emphasize appreciation to you and your committee for launching this salient and timely inquiry into the serious and substantial invasion by non tax paying entities into the tour and travel industry impacting thousands of America's small businesses presently providing tour and travel services.

Today I testify on behalf of the Government Affairs Council. In addition, as Washington, DC Representative of the National Tour Association and this year's Chairman of the Business Coalition For Fair Competition I have been exposed to the flagrant violations by non tax paying entities of the Unrelated Business Income Tax provisions by 501(c)(3) - non profit corporations and gross examples of unfair competition from some state and local government agencies who are engaged in the tour and travel business.

To assist the committee in understanding this basic concern of the tour and travel industry, I offer this definition of Unfair Competition as developed by the National Tour Association.

"The National Tour Association defines unfair competition as resulting when a tax-exempt organization -- a non-profit group or government-subsidized agency -- sells goods and services, on a frequent and ongoing basis, using its special privileges. The organization does not use for-profit intermediaries to provide its goods and services; rather, it sells similar products to compete directly with private, for-profit businesses."

First I will introduce the Travel and Tourism Government Affairs Council to the Committee. The Council encompasses all segments of America's diverse and dynamic travel and tourism industry. The 37 organizations that belong to the Council represent all modes of transportation, accommodation, food services, travel agents, tour sales and operations, attractions and recreation facilities, as well as state and local destination marketing organizations. In addition, 12 corporate executives belong to the Council as at-large members.

Travel and tourism is a $360 billion industry in the United States, generating nearly 6.1% of our GNP. It is our third largest retail industry after automobile services and grocery stores. Six million jobs are provided by travel and tourism businesses and another two and a half indirectly, making it our country's second largest employer, after health services. In 37 states, travel and tourism is one of the top three sources of jobs. During the 1980s, this industry generated new jobs at a rate twice as high as that of all other American industries. Another compelling sign of the economic importance of travel and tourism is the fact that it has become our nation's largest export; the money spent by international visitors to the United States makes travel and tourism our biggest earner of foreign exchange.

Yet, although travel and tourism is a huge industry, it is paradoxically an industry of small businesses. Nearly all (99%) of the half million firms in the travel and tourism industry are

classified as small businesses according to the U.S. Small Business Administration. Small businesses thrive in travel and tourism because entry costs are usually low with minimum technological and capital investment requirements, and, in an extremely competitive, service-oriented environment, personal, "hands on" attention can lead to success. Small businesses, however, with typically modest profit margins, are uniquely threatened by unfair competition.

For travel and tourism, unfair competition arises in two different forms: (1) unfair competition from not-for-profit, tax-exempt nongovernmental organizations, and (2) unfair competition from governmental agencies.

In the first category, tour operators and travel agents are the most likely segments of the industry to be affected. Their unfair competition is usually presented by such not-for-profit, tax exempt organizations as churches, educational institutions, museums and art galleries, along with trade associations and professional societies. These not-for-profits are usually membership organizations and have discovered that their membership bases provide excellent "captive" markets for selling tours and other tourism services. Thus, churches, museums and alumni groups sell and operate tours for their members, and even for the friends or acquaintances of their members. Colleges and universities operate on-campus hotels and rent their facilities for meetings and conferences. The result is loss of business and jobs by tax-paying, for-profit travel and tourism enterprises which cannot compete against the unfair advantage of organizations that are exempt from the Federal corporate income tax and most state taxes as well.

One specific arena of unfair competition concern for the Council is presented by the public land agencies, which many times construct and operate campgrounds and recreational facilities either in direct competition with existing private sector, for-profit, tax-paying businesses, or so as to discourage private sector entrepreneurs from establishing tax-paying operations.

We recommend that Congress address this form of unfair competition by requiring the Federal land agencies, before developing or expanding new public recreation facilities and services as campgrounds, to determine and publish their potential economic impact on existing for-profit enterprises serving the same market. Furthermore, for-profit enterprises should always be given the opportunity through public bidding to manage and operate recreation facilities owned by government agencies. In general, we urge that Federal policies provide maximum encouragement to private sector organizations to manage, operate and invest in the construction,maintenance and improvement of public accommodations, facilities and visitor services on the Federal lands.

The foregoing encompasses the tourism industry-wide prospective of the council's policy concerns about the basis inequities and/or illegalities practiced by the non tax paying travel and tourism competitors.

As your Committee focuses on the serious unfair competition experiences of small business abuses in the travel and tourism industry, I invite this Committee to consider the fact that you are exposing an unfair competition cancer that is impacting a large segment of all of small businesses in America.

In July 1986, the National Conference on Small Business, following two years of state by state, region by region, public hearings concluded in its Washington, DC meeting that "unfair competition" from non tax paying-non profits was one of the five major issues confronting all small businesses in America.

This year the Small Business Legislative Council, after considering over 50 basic problems besieging small business throughout the USA concluded that of all the "1993 Priority Issues" - unfair competition "by Government and Tax Favored Entities" was the #5 issue of priority concern to SBLC.

Finally, as recently as April 18 through April 25 the Philadelphia Inquirer presented an exhaustive investigative exposition of the multi billion dollar world of America's so-called non profit industries exposing, in several different contexts, the abuses of their unique tax exempt status.

Certainly this sweeping inditement by the Philadelphia Inquirer encompasses the world of non profit businesses sometimes run amuck. However, as you, Mr. Chairman, contemplate future oversight hearings into this multi billion dollar non tax paying competition for many of America's struggling small businesses you will find much factual fodder for your investigative cannon in this Inquirer series. A copy of this extra-ordinary seven-part series is hereby offered for your committee record and consideration.

Other witnesses before you today will offer specific case examples of patently inequitable competition from both governmental-tax supported entities and from traditional 501(c)(3) tax exempt entities. I will share only one example of how out of control this unfair competition can become. The tax exempt tour and travel abuse arena has reached criminal proportions. A zoologist and Department of Interior, Fish and Wildlife employee, Robert Mitchell incorporated a tax exempt organization to allegedly promote ecology. He has been charged with nine counts of obstructing and impeding the administration of IRS laws by inducing big game hunters to make "contributions" to the American Ecological Union (AEU) to arrange hunting excursions to China and Pakistan and then causing the hunters to file fraudulent income tax returns claiming charitable tax deductible contributions. This is a 1993 example of some of the extreme ongoing abuses by a non tax paying tax exempt organization promoting travel and tourism activities. There are many many more non criminal examples of this abuse.

In conclusion the council offers this committee the following remedial responses to the tour and travel unfair competition evidence that will be offered today for the committee's hearing record.

One - Your Committee, Mr. Chairman, can do much to pragmatically encourage those offending non tax payers in the travel and tourism business to clean up their act. Ten years ago I became actively involved in the issues addressed by your Committee today. Abuses in the travel and tourism industry were multiplying and rampant. There have been tangible improvements because many offending non profits have, since that time, engaged for profit travel agents or tour operators to conduct their travel business. These for profit entities pay taxes on their revenues. In '91 I spoke before the annual conference of the Nonprofits in Travel in Washington, DC. I requested a show of hands from all those non profit representatives about how many presently engaged the professional services of for profit tax paying tour operators or travel agents. Almost 90% of the 300 delegates raised their hands.

That tangible progress was in part the direct result of Chairman Jake Pickels' (D-TX) Oversight Committee of Ways and Means '87/'88 inquiries into the basic issue of unrelated business income tax violations by some of the nation's 501(c)(3) organizations. The public exposure and corresponding media coverage did produce a deterrent impact in the world of ongoing UBIT abuses. Your Committee's 1993 hearings will continue the deterrent impact of public exposition.

Two - The council recommends that Congress address this unfair competition by directing the Internal Revenue Service to strictly enforce the Federal unrelated business income tax (UBIT) against all income earned by such tax-exempt organizations from travel and tourism activities. It strains credulity to believe that such activities are related to the "exempt purpose" of these organizations The activities are pure "revenue raisers" and, as such, should be fully subject to the UBIT.

Three - The council also recommends that no Federal employee be reimbursed by the government for expenses incurred to attend or participate in meetings, conferences or other activities on the property or facilities of such tax-exempt organizations, unless full UBIT payments are certified to have been made.

Four - A recent IRS Technical Advice Memorandum (TAM) by the IRS enunciates with some specificity the standards by which 501(c)(3) will be evaluated to determine if there has been the UBIT violation. The Committee should emphatically urge the IRS to enforce these standards. The case example follows.

In December 1991, the IRS issued a Technical Advice Memorandum (TAM) to a major national nonprofit organization (hereinafter "NONPROFIT") generally exempt from income tax under section 501(c)(3) of the Internal Revenue Code. In furtherance of its exempt purposes, NONPROFIT engaged in the following activities: "Conducting and sponsoring conferences; publishing educational material; directing tours, and sponsoring study tours." Domestic tours were arranged and conducted through NONPROFIT'S internal operations, while for-profit tour operators presented the international tour packages."

The IRS analyzed the question of whether the tour activity was "substantially related" to NONPROFIT'S otherwise tax-exempt educational purposes.

> "Whether the tours in general, or any one or more of them, in particular, are substantially related to the accomplishment of the exempt purposes of the organization."

The IRS issuance of factors which must be met to show "relatedness" is significant.

> 1. A bona fide educational methodology through a formal educational program including organized study, reports, lectures, library access, reading lists, and mandatory participation.
>
> 2. The tour is conducted in a highly professional manner, with daily lectures and related classroom studies.
>
> 3. The tour is arranged to allow participants to perform an intensive study of the subject of the tour and to receive academic credit at the college level when appropriate.
>
> 4. The tour is selected for its educational value and the qualification of the tour leaders.

This TAM does not technically carry precedential value. However, because the TAM sets forth specific factors for application to tour programs of organizations claiming tax exempt status it is probable that the TAM will be generally applied for enforcement purposes among all IRS enforcement offices. Its nature is such that it should have determinative uses in many other cases.

As further evidence of intensified scrutiny by the IRS into travel and tourism business activity by non profits, see, e.g., the 1993 "Announcement 93-2" directed to exempt organization: "Proposed Examination Guidelines Regarding Colleges and Universities."

These guidelines provide factors to be used by IRS agents during examination of colleges and universities providing a framework for agents to follow in the course of their investigations - one of the focuses of these exams in "unrelated business income tax issues."

Under the UBIT "considerations" 342.(13)(2)(c) is "Operation of hotels/motels" and 2(e) "travel tours." The IRS is honing in on perceived business activities in violation of the Unrelated Business Income Tax laws and regulations.

To gain an understanding of the scope and magnitude of the UBIT travel and tourism and other small business unfair competition problems I would urge the Committee to continue

this oversight inquiry with other tax paying small businesses who are confronted by, and struggling to compete with, other non tax paying business competitors.

In conclusion, I commend this committee for instituting public focus and attention to this basic survival challenge to the small business travel and tourism industry.

The Philadelphia Inquirer

City Edition • Sunday, April 18, 1993 $1.50

Warehouses of Wealth: The Tax-Free Economy

First in a series.

They're called nonprofit businesses, but that doesn't mean they can't make money. They do — billions of dollars. At the same time, their tax exemptions cost government more than $36 billion a year.

Nonprofits: America's growth industry

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS
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The National Football League, that bastion of free enterprise and million-dollar quarterbacks, doesn't look like a nonprofit organization. Then again, it doesn't act like one, either.

The NFL spends less than 1 percent of its $15 million budget on charitable activities, pays its commissioner $1.5 million a year, and spends another $1.5 million to lease seven floors of a Park Avenue office tower.

Or take the Motion Picture Academy of Arts and Sciences, which spent $6 million to put on the dazzling Oscars show.

You thought nonprofit organizations had to be charities, run by meagerly paid managers and volunteers?

Not anymore.

Thanks to the remarkable largess of Washington lawmakers, an ever-expanding definition of charity and a near-total collapse of government supervision, America's nonprofit economy has become a huge, virtually unregulated industry.

Each year about 29,000 new groups are declared nonprofit and go off the tax rolls.

Within it, almost anything and anybody qualifies for tax-exempt status.

Auto racing promoters. Collection agencies. Country clubs. Criminals. A half-billion-dollar defense research corporation. Investment houses. Mail-order colleges. A polo museum. Retail stores. Professional surfers. An association of Druids. Foreign real estate investors. Space explorers. Even a chili appreciation society.

Each year for the last dozen years, an average of 29,000 new groups have been declared nonprofit and gone off the tax rolls. Today, an estimated 1.2 million organizations are exempt from taxes — not counting churches, which don't even have to apply.

Think of it as Congress' contribution to charity.

And you make up for the taxes they don't pay.

A major but little-noticed change has taken place in the American economy in the last 20 years: the dramatic growth of nonprofit businesses.

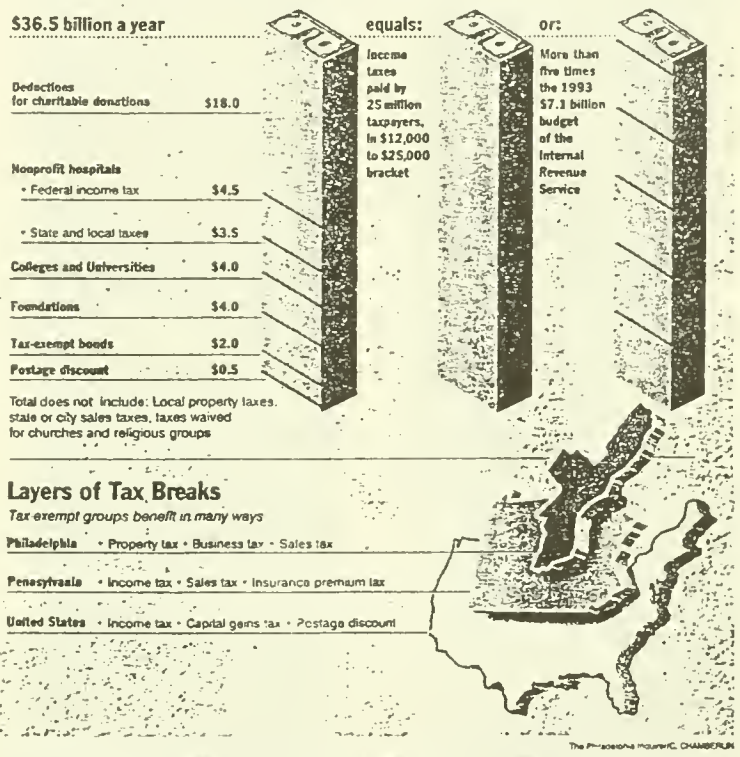
These businesses had an estimated $500 billion in revenues in 1990 — nearly six times the income of farms, five times that of utilities and twice as much as the construction industry.

They represented roughly 6 percent of the nation's total economic output and employed about 7 million people.

Since 1970, this tax-exempt sector has grown four times as fast as the rest of the economy.

In Philadelphia, nonprofits account for one of every six jobs among private employers. From the University of Pennsylvania, with 1991 revenues of $1.3 billion, to the Sonny Hill community basketball league, with revenues of $279,000, nonprofits affect the lives of Philadelphians in untold ways.

Cost of Tax Breaks for Nonprofits



Layers of Tax Breaks

Tax-exempt groups benefit in many ways

Philadelphia • Property tax • Business tax • Sales tax

Pennsylvania • Income tax • Sales tax • Insurance premium tax

United States • Income tax • Capital gains tax • Postage discount

THE PHILADELPHIA INQUIRER, CHAMBERLAIN

Nonprofit hospitals, universities, museums and churches own large parcels of real estate, on which they pay no property or income taxes. Even the most dramatic building on the Philadelphia skyline, One Liberty Place, was built with financing help from a nonprofit pension fund.

Nationally, nonprofits control property, cash and investments worth more than $850 billion — and that is a conservative estimate. Because neither churches nor smaller nonprofit groups have to report income or assets, the true figure probably exceeds $1 trillion. Government economists acknowledge that they don't track the tax-free economy or its impact.

To put $850 billion in perspective, if the holdings of nonprofit groups and foundations were liquidated tomorrow, there would be enough to write a $3,401 check for each man, woman and child in America. Or enough to pay off last year's federal deficit and have more than $500 billion left over for Bill Clinton to spend.

These exemptions are costing more than $36.5 billion a year in lost tax revenue — at a time when President Clinton is asking Americans to shoulder an increasing tax burden. That is the equivalent of the income taxes paid by 25 million taxpayers.

At the local level, the exclusion of billions of dollars worth of property from the tax rolls of cash-starved school districts and municipalities is increasing budget woes and straining social services.

The transformation of this nonprofit economy has happened largely without notice, forethought or national debate about the consequences and public policy implications for the country.

Nonprofit groups do a lot of good in a lot of areas for a lot of people. That's why they were granted exemption from taxation. But as Congress has become more and more liberal with the nonprofit designation, and as the Internal Revenue Service has become swamped, abuses have grown.

An 18-month study by The Inquirer, which included examination of tax returns of 5,000 exempt organizations, found that:

• Many nonprofits operate just like for-profit businesses. They make huge profits, pay handsome salaries, build office towers.

See NONPROFIT on A10

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The expanding definition of 'nonprofit'

NONPROFIT from A1

invest billions of dollars in stocks and bonds, employ lobbyists and use political action committees to influence legislation. And increasingly they compete with taxpaying businesses.

• Executives at some large nonprofit businesses make more than $1 million a year. Of 25,000 salaries examined of executives of big nonprofit organizations, nearly half were at least $100,000 a year. The top compensation in 1991 was NFL commissioner Paul Tagliabue, who was paid $1,511,731 in salary and benefits. Many also received such perks as free housing, maid service, luxury cars and chauffeurs, and no-interest loans.

• Nonprofit hospitals, which originally were exempted from taxes because of their charity care, now devote an average of 6 percent of expenditures to caring for the poor. In the Philadelphia area, the figure is even less. Meanwhile, more than $1 billion in hospital profits have been shifted to commercial spinoffs — hotels, restaurants, health spas, laundries, marinas, parking garages.

• Private, nonprofit colleges and universities have more than doubled their tuition in the last decade, even though their income from investments was doubling and tripling in the 1980s. Some schools — including MIT, CalTech and Penn State's main campus — now spend more on research than on teaching; these schools collect millions of dollars for work done under contract to commercial companies. This income is shielded from taxes, and the companies get a tax write-off.

• Private foundations have become great warehouses of untaxed wealth. Most foundations give away only the minimum required by law, 5 percent of their assets each year, while earning much more on investments. With $163 billion in assets, they are operated like private banks, with elite, self-perpetuating boards of directors. Where they invest their money and how they vote their stock give these boards great economic power.

• A multibillion-dollar pool of cheap money, available through low-interest loans to tax-exempt organizations and subsidized by taxpayers, has financed a massive expansion of hospitals and universities. Some have overbuilt: On any given night, one third of the hospital beds in America are empty. In Pennsylvania, more than 100 government authorities issue low-interest tax-exempt bonds, with few questions about whether the projects are needed.

• Dozens of directors and executives of nonprofit institutions own or are officers of outside companies that do business with the nonprofit. The services they provide range from legal and financial advice to selling the nonprofit food or other goods. The IRS requires disclosure of such relationships, but only minimal details about finances.

• The Internal Revenue Service, which is charged with policing nonprofits, is so understaffed — and the number of exempt organizations so large — that it would take 79 years to audit them all at the presedt rate. Most applications for nonprofit status are rubber-stamped by IRS; even convicted felons have been approved.

"Until I looked, I thought being declared a nonprofit was pretty hard. Then I found something like 95 or 99 percent who apply get approved. It's like getting your driver's license," said Ted Chapler, executive director of the Iowa Finance Authority, which arranges tax-exempt financing for nonprofit organizations.

Don't be misled by the word *nonprofit*. It does not mean these groups cannot earn a profit on their services. They make plenty of profit — although they don't call it that.

Under the federal tax code, nonprofit businesses may accumulate net income, so long as they don't distribute it as dividends or stock. Where does the money go then? In many cases, to expand their empires.

That means to construct new buildings, expand services, acquire competitors, increase executive salaries and hire high-priced consultants, among other things.

"I call it the culture of the nonprofit," said Princeton University economist Uwe Reinhart. "You can't keep the money for yourself, right, so you do the next best thing. You put up another building or give yourself a raise. As a nonprofit, who's going to question this?"

As they've expanded, many large nonprofit organizations have moved beyond their core mission into commercial businesses that have little, if anything, to do with their exempt purpose.

Under the tax code, nonprofits are allowed to operate commercial subsidiaries — so long as they pay taxes on that income and those activities don't overshadow their exempt mission.

"The idea that tax-exempt organizations always wear white hats in the community, going around doing things that benefit everyone and helping the poor ... as opposed to that other part of society that gropes for money all day long, is not something that is rooted in fact," Marcus S. Owens, director of the IRS's Exempt Organizations Technical Division, told nonprofit officials in a candid 1991 speech.

Originally, tax exemption was granted to groups that relieved the government of having to provide a service — schools, hospitals, social service agencies and the like. The law limited tax-exempt status to charitable institutions, which received their funds mostly from private donors.

There are still many small nonprofits staffed by volunteers and low-paid workers that provide needed services to their communities.

But over the years, three basic changes have occurred with large nonprofits.

Instead of depending on charitable contributions, many tax-exempt businesses began charging fees for services. And the fees kept rising.

Also, federal programs — Medicaid, Medicare, Social Security disability — began paying for many of the services once provided by charities.

And Congress, responding to special interests, expanded its definition of nonprofit to include many new categories, such as federal groups, trade associations, mutual life insurance companies, health insurance firms, labor unions, retirement funds, cemeteries and credit unions.

Today there are 25 categories of nonprofits — including the one that covers the NFL.

Congress rewrote the tax laws in 1966 to declare the professional football league a not-for-profit enterprise, inserting the NFL in the same section of the tax code that exempts boards of trade and local chambers of commerce from federal taxes. The exemption covers only the league organization, not the teams and players within it.

Nor is the NFL the only professional sports organization to benefit. The National Hockey League, Professional Bowling Association, Professional Golf Association, U.S. Tennis Association and the players' associations of football and major league baseball are among the many tax-exempt sports groups.

Then there's the National Museum of Polo & Hall of Fame. Its exempt purpose "relates to the operation of the Polo Museum and Hall of Fame at the Kentucky Horse Park in Lexington, Ky." Among its major 1990 expenses: tent rental, catering and dinner at the Club Collette in Palm Beach, Fla.

■

In January, officials at Memorial Sloan-Kettering Cancer Center in New York mailed a plea for funds for cancer research.

"Right now cancer research is being threatened by cutbacks in federal funding of research. This could seriously hinder our efforts to find more effective treatments and cures," said a "Special Note" to would-be contributors.

The note did not say that Sloan-Kettering is one of the wealthiest hospitals in the nation, with more than $500 million in cash and investments.

Or that the renowned cancer facility had more than $250 million in reserves available for any purpose, including research. Or that the center is the sole beneficiary of a $92 million trust fund, which underwrites research at an affiliated laboratory.

Sloan-Kettering is a prime example of how wealthy some nonprofits have become, while continuing to solicit contributions.

"Our reserves are substantial," Mortimer H. Chute Jr., Sloan-Kettering's $195,000-a-year vice president for development, acknowledged in an interview. But, he said, "we want to do more things. We need private philanthropy to greatly expand our research efforts."

Chute said that Sloan-Kettering's federal research funding had not "kept pace with inflation, with the Consumer Price Index." He did not have specifics, and officials did

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not respond to requests for that information.

In 1990, Sloan-Kettering spent $8.1 million on fund-raising and received contributions and pledges totaling $59.3 million, according to its IRS tax filing. It made $27 million in profit, which nonprofits call a surplus. That was down from $54 million a year earlier.

This is big business, by anybody's definition.

For most companies, earning 10 cents in profit on every dollar in revenue would be considered a very good year.

Many large nonprofits make that much and more.

In 1991, the University of Pennsylvania made 11 cents in profit for each dollar it took in — $153 million profit on revenues of $1.3 billion. A year before, it made 13 cents on the dollar. During most of the 1980s, Penn enjoyed double-digit profit margins.

Princeton University has done even better. In 1990, it made 32 cents profit on every dollar of revenue — $197 million on revenues of about $613 million. Only one public company, Newmont Mining Inc., had a higher profit margin in the Fortune 500 rankings that year.

Then there's the Bible business. In 1991 the nonprofit American Bible Society made 55 cents on each dollar of revenue — $52 million on revenues of 595 million. The Society's $350 million in investments was enough to run the business for eight years.

As these examples show, many nonprofit businesses are highly profitable. An Inquirer computer analysis of 630 large nonprofits found that they had an average profit margin of 9 percent in 1990 — more than double the average of Fortune 500 companies.

All figures are based on Form 990 returns the businesses filed with the IRS. Exempt organizations are required to file a 990, even if they had no taxable income. The filing requirement does not apply to nonprofits with revenue of less than $25,000 a year or churches.

These big profit margins are, in part, the result of not having to pay taxes. If these were for-profit companies, they would have to pay up to $340,000 in federal income taxes for every $1 million in operating income. They also would be subject to a maximum 28 percent capital gains tax on any investments they sold. And they would have to pay local property, sales and other taxes.

Harvard University, which has an investment portfolio worth $5 billion, had 1990 profits of $230 million — a 17.5 percent margin.

Not every nonprofit made money. Mt. Sinai Hospital in Philadelphia, a division of the Graduate Health System, recorded a loss of $16.8 million.

As a group, however, hospitals and health-care organizations were among the most profitable. The Mayo Clinic Foundation in Rochester, Minn., had a profit of nearly $90 million on revenues of $642 million.

Mayo's 14 percent profit margin would have ranked it ahead of such pharmaceutical companies as Johnson & Johnson Inc., Pfizer Inc. and Warner Lambert Inc. And the drug industry is considered the most profitable business in America.

Mayo was so wealthy, it ended 1991 with $979 million in unrestricted funds, money it could use for whatever it chose. It operated 11 taxable subsidiaries, including an airport management company, and had 28 companies in all. Mayo owned buildings, property and equipment valued at $773 million, including spinoff clinics in Jacksonville, Fla., and Scottsdale, Ariz.

Another charity that fared well was Father Flanagan's Boys Home, better known as Boys Town, near Omaha, Neb. In fiscal 1989, it had a profit of $29 million on income of $93 million — a 31 percent margin. That would have dwarfed margins of IBM, General Motors, Reebok or Time-Warner.

Boys Town, popularized in a 1938 film featuring Spencer Tracy and Mickey Rooney, owned stocks, bonds, property and Treasury bills worth nearly $423 million. It had four outside advisers to manage its investment portfolio.

In 1990, Boys Town officials set up a separate tax-exempt foundation, Father Flanagan's Foundation Fund Inc., and transferred $371 million in investment holdings. Since then, the value of the foundation's holdings has increased to $478 million.

Boys Town's treasurer, Jim Schmidt, said the goal was to build up the foundation's wealth and use a portion of the interest income to help support Boys Town's expanding activities nationwide.

During the civil rights era, the struggling Southern Poverty Law Center in Birmingham, Ala., battled poll taxes, racism and the Ku Klux Klan. Today, it, too, is building up cash reserves.

Thanks to an aggressive fund-raising campaign, the law center made 45 cents in profit on each dollar in revenue it took in during 1990 — $4.5 million on $10 million in revenue. The year before it made 59 cents on the dollar.

These days, the center spends more on education than lawsuits. "When we started out in the '60s, we were the only ones down here in the South taking on these issues," said executive director Morris Dees. "Nowadays, it's no longer hard for other lawyers to take these cases. ... It's a natural outgrowth, moving from the courtroom to the classroom."

The center's investment holdings were $44 million as of July 1992. "Our goal is to build toward a time where we won't be dependent on direct mail appeals, a time we will be totally self-sufficient," Dees said. "We believe $100 million in endowment will be enough."

The Pennsylvania Horticultural Society is also building its bank account. Thanks to its generous donors and the $1 million profit it usually makes sponsoring the Philadelphia Flower Show, the nonprofit group's investment holdings grew from $4.5 million in 1989 to $6.1 million in 1992.

Last month, a blizzard forced the flower show to close early the final weekend, cutting profits by half — or $510,000. The society put out a call for donations.

"As you can well imagine, the losses caused by the blizzard are devastating," a fund-raising letter said. Tax-exempt donations would "be used to cover the costs of providing uninterrupted PHS programs," such as the Philadelphia Green neighborhood gardens, the letter said.

The Horticultural Society could have gone into its $6.1 million reserves to make up the shortfall.

"We look at that not as a reserve but as an endowment which this year and future years is going to provide income. So if you dip into that, then you lose income in the future," said society president Jane G. Pepper.

Congress has not placed limits on the profits that tax-exempt groups may make. Nor has it addressed whether there should be limits on their investment portfolios. Absent such rules, all the IRS can do is try to "track where the money is going," IRS's Owens said.

■

The impact of this expanding tax-exempt industry is being felt throughout America.

In such Pennsylvania counties as Beaver, Montour, Lehigh, Lawrence and Lycoming, the largest employer isn't a private company. It's a nonprofit hospital.

In cities like Philadelphia, nonprofits dominate the job market. In 1992, eight of the 10 biggest employers in Philadelphia County paid no property or income taxes. They were either government agencies or nonprofit organizations, like the University of Pennsylvania, Temple University and Thomas Jefferson University.

The only tax-paying companies among the 10 biggest employers were Bell of Pennsylva-

Continued on next page

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nia and Philadelphia National Bank.

In the Philadelphia, South Jersey and Delaware region last year, nonprofits brought in revenues exceeding $18 billion, of which more than $7 billion was in the city.

That $18 billion — virtually all of it untaxed — was more than the state budget for New Jersey. It was more than the combined revenues of Campbell Soup, Scott Paper and Philadelphia Electric Co.

In Pennsylvania alone, 20,000 charitable groups in 1991 took in $33 billion — up from $20 billion in 1985. That six-year growth rate of 65 percent was more than double the rate of inflation. And that was just charities; the figure doesn't include an estimated 60,000 other tax-exempt groups.

In Cambria County, seven of the 10 biggest employers in 1990 were government agencies or nonprofit groups. Bethlehem Steel ranked as the number one employer, but the company is preparing to shut down its Bar, Rod and Wire Division in Johnstown.

If that happens, the area's most important source of jobs would be three nonprofit hospitals.

■

Many nonprofits defend their tax-exempt privilege by citing their economic contributions to their communities.

A year ago, the University of Pennsylvania released a university-financed study reporting that Penn "contributes at least $2.5 billion to the state's economy — including $1 billion to household earnings — and supports more than 40,000 jobs in the state."

The Delaware Valley Hospital Council hired the Pennsylvania Economy League to measure the economic impact of its member hospitals. "Our hospitals employ more than 72,000 people. Salaries and wages alone add about $2 billion annually to the economy and about $60 million to the city in wage tax," president Jeff Flood said in 1991.

Such economic power is important. But it has nothing to do with why hospitals, universities or other nonprofits were exempted from taxes. Those reasons have to do with their charitable and social missions, not the jobs they create.

Otherwise, Wanamakers and Strawbridge & Clothier would be tax-exempt, too.

In some tax-strapped communities, nonprofits' growing wealth and economic power are now drawing attention to their privileges.

Officials in Pittsburgh and surrounding Allegheny County three years ago began threatening to tax nonprofit organizations. Since then, some hospitals, a blood bank and a YMCA have agreed to make annual payments in lieu of taxes.

In Philadelphia, the Board of Revision of Taxes recently rejected applications for tax exemptions on new property owned by the nonprofit American Red Cross' Penn-Jersey Regional Blood Services and the National Board of Medical Examiners, saying these groups did not serve a charitable purpose.

The mayor's office is studying whether to seek payments in lieu of taxes from hospitals, universities and other nonprofits.

In financially strapped Johnstown, Mayor Herb Pfuhl last year called publicly on Conemaugh Valley Memorial Hospital to pay its share of taxes. Hospital officials responded with an offer to provide some health services free and to donate police and fire gear. Pfuhl rejected the offer, saying, "It will not relieve the burden of the average taxpayer."

In Langhorne Borough, Bucks County, officials amended the township's zoning ordinance in 1991 to limit "property devoted to tax-exempt or nontaxable uses" to 25 percent of the borough's total acreage. A borough attorney said the ordinance was designed to prevent any further erosion of the tax base.

Two years ago, officials in Wayne County, Pa., voted to put back on the property tax

Who's a nonprofit? Here are a few examples

	National Hockey League	MITRE Corp.	National Rifle Association	Seeing Eye Inc.	American Association of Retired Persons	C-SPAN	Philadelphia Cricket Club
LOCATION:	Montreal	Bedford, Mass.	Washington	Morristown, N.J.	Washington and Los Angeles	Washington	Philadelphia
PURPOSE:	Runs professional hockey league	Engineering services for government	Lobbies, publishes magazines, supports gun owners	Trains guide dogs for people who are blind	Lobbies on behalf of elderly	Television coverage of Congress	Golf, tennis and swim club
REVENUES:	$12 million in 1990	$572 million in 1991	$86 million in 1990	$11 million in 1990	$300 million in 1990	$17.7 million in 1991	$3.9 million in 1991
PROFIT:	$0	$8 million	$399,200	$4.3 million	$14.5 million	$3.1 million	$221,984
ASSETS:	$0	$103 million	$11 million	$85 million	$124 million	$16 million	$3.8 million
PRESIDENT:	John A. Ziegler, paid $500,000; received $300,000 no-interest loan to buy a house	Barry M. Horowitz, paid $267,168	Joe Foss, not paid	Dennis J. Murphy, paid $170,100	Horace B. Deets, paid $249,449	Brian Lamb, paid $203,738	William M. Surgner, not paid
OF NOTE:	Listed European scouting ($165,418) and Hockey Hall of Fame ($255,000) as expenses	Helped to develop AWACS and other defense industry surveillance systems	Owned $89 million in investments, has Political Action Committee	Owned $77 million in securities, enough to operate 11 years without additional income	Revenue from dues, health insurance, travel plans, prescription drugs and advertising	Nearly all revenues from fees paid by for-profit cable companies	Club dues account for nearly all revenues

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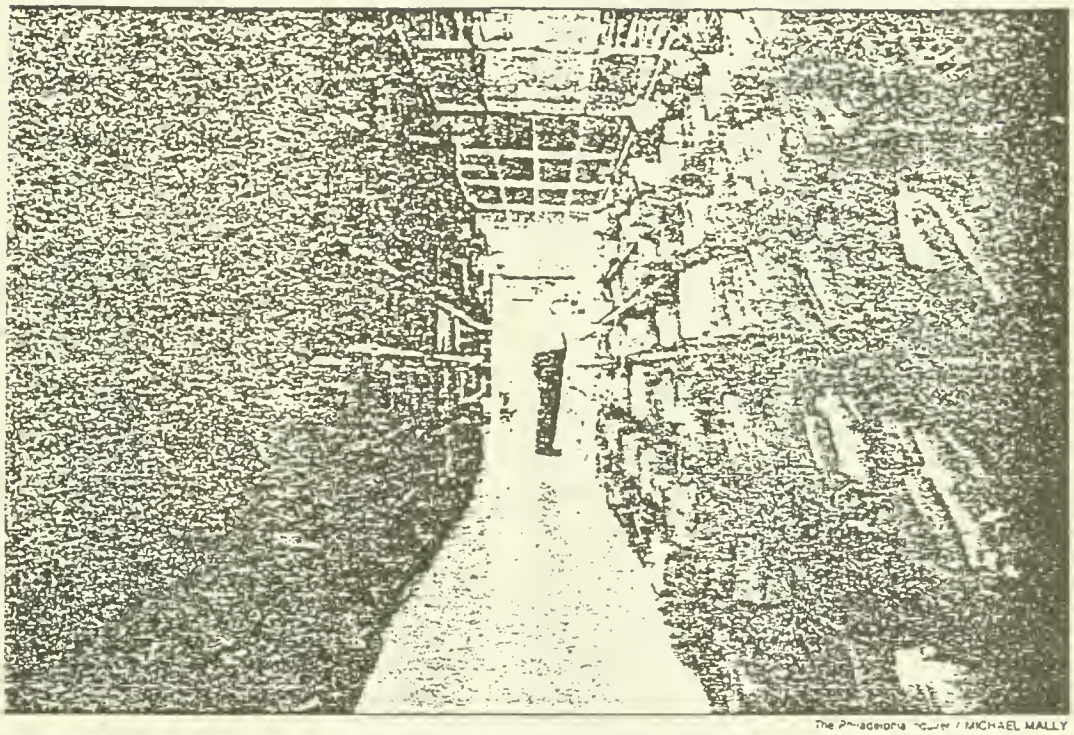

The Philadelphia Inquirer / MICHAEL MALLY

The IRS service center in Philadelphia stores about 75,000 Form 990s, a tax return that all nonprofit organizations must file. The organizations are exempt from taxes, except on income from business not directly related to their exempt purpose.

Types of Tax-exempt Groups

Figures refer to sections of the U.S. Tax Code.

501 (c) (1) Corporations organized under an act of Congress.

501 (c) (2) Title-holding companies.

501 (c) (3) Charitable, educational, literary, religious, scientific organizations; organizations to prevent cruelty to animals, to prevent cruelty to children, for public safety testing.

501 (c) (4) Social welfare; civic leagues; associations of emoloyees.

501 (c) (5) Labor, agricultural, horticultural organizations.

501 (c) (6) Business leagues; boards of trade, chambers of commerce; real estate boards.

501 (c) (7) Social and recreational clubs.

501 (c) (8) Fraternal beneficiary societies.

501 (c) (9) Voluntary employees' beneficiary societies.

501 (c) (10) Fraternal beneficiary societies

501 (c) (11) Teachers' retirement fund.

501 (c) (12) Benevolent life insurance associations; Mutual Ditch or Irrigation Co.; Mutual Cooperative Telephone Co.

501 (c) (13) Cemetery companies, burial associations.

501 (c) (14) Credit unions.

501 (c) (15) Mutual insurance companies.

501 (c) (16) Corporations to finance crop operations.

501 (c) (17) Supplemental unemployment benefit trusts.

501 (c) (18) Employee-funded pension trust.

501 (c) (19) War veterans' organizations.

501 (c) (20) Legal services organizations.

501 (c) (21) Black lung trusts.

501 (c) (23) Veterans association (formed before 1880).

501 (c) (25) Title-holding company for pensions.

501 (d) Religious and apostolic organizations.

501 (e) Cooperative hospital service organizations.

501 (f) Cooperative service organizations of operating educational organizations.

501 (k) Child-care organization.

521 Farmers' cooperatives.

4947 (a) (2) Nonexempt chantable trust.

SOURCE: Internal Revenue Service

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rolls more than 1,000 acres owned by three New York-based summer camps. Their reasoning: Because the camps charged fees, they weren't charities. Attorneys for the camps appealed to the county court, then to Commonwealth Court — and lost at both levels.

In 1988, Erie County officials revoked the tax-exempt status of the 536-bed Hamot Medical Center, one of the area's largest employers. The county said that after a 1981 corporate reorganization, Hamot had shifted $25 million in hospital profits to a holding company and subsidiaries involved in real estate development and other commercial ventures, including a marina on Lake Erie.

Hamot officials filed suit and a trial was held in Erie County's Court of Common Pleas. In May 1990, Judge George Levin ruled that the Hamot executives had "lost their identity" as hospital officials "and their dominant purpose was no longer the promotion of health, but to fund HHSI [Hamot's parent organization] and its various subsidiaries."

Levin upheld the county's decision to tax Hamot and its affiliates. The hospital appealed to Commonwealth Court and lost there, too. Last June, Hamot's board of directors announced that they would cease operations of many of the subsidiaries and again focus on health care.

"We have an obligation to the patients and the more than 2,500 people who work at Hamot to carry out our mission in a way that responds to community expectations for nonprofits," Hamot Chairman Bruce Ramsy said.

Last July, State Sen. Michael E. Bortner of York introduced a bill allowing Pennsylvania cities to levy service charges on some tax-exempt properties. The measure was designed to help cities in which there are large numbers of nonprofit organizations.

"This has eroded the tax base and forced homeowners and small businesses to carry the total burden of supporting municipal government services," Bortner said in introducing the bill.

■

"Taxes are the lifeblood of government and no taxpayer should be permitted to escape the payment of his just share," Judge Levin wrote in his Hamot opinion.

Yet an Inquirer examination of the way the federal government awards tax-exempt status shows it amounts to little more than a rubber stamp.

The Exempt Organizations Technical Division of the IRS receives thousands of applications each year for exemption.

At a June 1988 hearing of the House Committee on Small Business, a Treasury Department official was asked about the ever-expanding categories of nonprofits.

"It would seem almost irreversible," Assistant Treasury Secretary Adelbert L. Spitzer replied. "There are currently 25 categories of exempt organizations. It presents problems."

"Is it possible that we should be looking at the basic definition of ... what should be tax-exempt? And try to really minimize the number of categories, tighten up the definition?" Rep. James R. Olin of Virginia inquired.

"We think the subject is certainly worth exploring and is a review we have recommended Congress undertake," Spitzer responded.

But Congress didn't follow through. It has not examined the basic issue of who qualifies for tax-exempt status in nearly a quarter-century.

Meanwhile, the IRS moves the applications through.

In 1990, the most recent year for which figures were available, the IRS rejected 656, while approving 38,649. Applicants had a 1-in-60 chance of *not* being approved. A decade before, the rejection rate was 1-in-27 applicants.

The application asks a series of questions, such as the names and addresses of the organization's incorporators and what charitable activities they intend to conduct. So long as the applicants fill in reasonable answers and pay a $375 filing fee, there is little chance of being rejected.

"We accept as truthful the statements the applicants make on the application," said the IRS's Owens.

There have been any number of abuses. Take the case of Edwin E. Whitis 2d, a 43-year-old Texan with a history of legal troubles.

In 1988, the Austin IRS office approved an application submitted by Whitis, his wife, Deanna, and a Rev. Harvey Couts seeking tax exemption to operate a national charity for abused and battered children.

Rev. Couts, it turned out, did not exist. When federal officials went looking for him, the only person they could find by that name had been dead for five years.

On the Dec. 31, 1987, application, the Whituses said they planned to raise money through television ads, direct mail appeals and by operating bingo games and holding car washes and other neighborhood drives. The money would assist abused children at their ranch and "build a 500-bed medical facility for the seriously injured child."

Based on his past, Ed Whitis seemed like an unusual choice to operate a charity for children.

Police and court records in Texas show that Whitis had been arrested on eight occasions between 1970 and 1977 on charges ranging from forgery and stealing credit cards to possession of heroin. He had received probation on the heroin charge and later served two years in federal prison on a conviction in a check-writing scheme involving stolen mail. In the early 1980s, Whitis served a second prison term on separate charges of theft and forgery.

About the time his application for America's Battered Children was being reviewed by the IRS in 1988, Whitis was involved in a scam that bilked investors out of $3.2 million, according to federal court records.

Whitis pleaded guilty following a 1988 fraud indictment that said he and three others took millions of dollars in "advance fees" from borrowers without arranging any loans. He is serving 5½ years in federal prison.

How could someone like Whitis slip by the IRS to earn taxpayer-subsidized charity status?

"Nobody ever asked me about my past," Whitis said by phone from prison in Oakdale, La.

"You don't have to submit a resume or anything, and the application doesn't take that into account. They don't even ask if you have a criminal past. If they had, I would have told them. I wouldn't have tried to hide it."

Indeed, the IRS application for tax exemption, known as Form 1023, does not ask whether the applicant has been convicted of a crime. Owens said such a question wasn't needed, because not many criminals apply.

Whitis insisted that America's Battered Children was not a scam. "I don't want anyone to think we had the wrong intentions because of my past misdeeds."

Only after Whitis' indictment became public did IRS audit the books of America's Battered Children. The agent discovered a number of unusual things.

The charity's assets consisted of $433,282 in cash and 375 gold bars, valued at $175,000.

One of its major transactions involved the purchase, for $223,541, of a ranch the Whituses had bought for $174,500 about 18 months earlier.

As directors of America's Battered Children, the Whituses authorized $75,292 in improvements to the ranch. These included $6,043 for draperies, $11,374 on an atrium, $3,395 on landscaping, $6,866 on carpeting and nearly $33,000 on carpentry.

On March 7, 1991, the IRS revoked the nonprofit status of America's Battered Children, retroactive to Dec. 31, 1987. From prison, Whitis is appealing.

■

Once an organization is declared tax-exempt by the IRS, it usually can piggyback other tax exemptions onto the federal one.

It can seek exemption from local property taxes, state corporate income taxes and sales taxes and borrow money from hundreds of quasi-public authorities that issue tax-exempt bonds. The bonds carry lower interest rates than conventional loans, and the buyers are exempted from taxes on interest they earn.

Nonprofits also can apply for reduced postal rates. In 1992, nonprofit groups saved an estimated $500 million using discounted mail.

No one has the foggiest idea what all these local, state and federal exemptions cost taxpayers.

"Historically, an estimate of the impact has never been done. It goes back to when the federal income tax was first enacted in 1913; no one thought to include such an estimate," an economist at the U.S. Treasury said.

The Inquirer's calculations — based on budget estimates, congressional hearing re-

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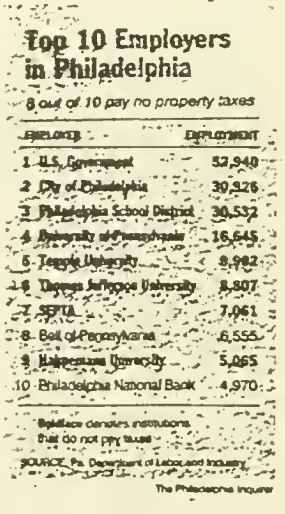

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Phila. looks for ways to make up lost taxes

The city re-evaluates who isn't paying and why.

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS

More than 4,000 properties, worth at least $3.6 billion, are owned by nonprofit institutions and are exempt from real estate taxes in Philadelphia.

If these hospitals, colleges, museums and churches paid property taxes, the city could count on $95 million more a year.

That's about one-eighth of the amount the city now collects in property taxes.

After years of paying next to no attention to this off-the-books property, city officials are following the lead of other communities and looking more closely at just who is shielded from taxes and why.

In March, the city's Board of Revision of Taxes rejected two applications for multimillion-dollar exemptions from nonprofit groups that for decades have enjoyed freedom from real estate taxes. Both are exempt from federal and state taxes.

The board rejected American Red Cross' Penn-Jersey Regional Blood Services' request for exemption from taxes on the Somerset Knitting Mills plant on Spring Garden Street. The Red Cross is appealing to the board.

The blood services unit plans to spend $17 million to turn the factory into a headquarters for regional blood processing. Its 23d Street facility, which is tax-exempt, would be sold.

Also rejected was a request from the National Board of Medical Examiners to exempt a new $23 million headquarters at 38th and Market Streets. The board's current building on Chestnut Street is tax-exempt; a move is expected this fall. The board tests physicians for state licensing.

Pittsburgh collects fees from nonprofits in lieu of taxes. Philadelphia is starting to look into the idea.

In evaluating the applications, the tax board examined the groups' financial statements. The Red Cross' blood services, which had revenues of $51 million in 1992, had net earnings of $1.5 million and $2.6 million in investments. In 1991, the Medical Examiners Board, with revenues of $25.9 million, had $7.5 million in net income and $38 million in investments.

"What's the charity here? I don't see it, quite frankly," tax board chairman David B. Glancey told the medical group when its request was heard in early March.

"What do we say to a citizen who simply has a home and pays taxes?" Glancey asked. "We are asking the citizens of Philadelphia to subsidize the real estate taxes of this particular property."

When the Red Cross presented its case, board member Robert N.C. Nix 3d asked: "Is there a percentage of your product that you give away?" Robert B. Bennioger of the Red Cross responded, "We don't have a program that provides free blood."

"Part of the test is: What's your charity?" Nix said.

Across the nation, local officials are asking similar questions about the ever-growing amount of property that slipped off the tax rolls in the last 20 years.

Many communities barely keep track of it. Of those that do, market values often haven't been updated in years.

"Our tax base is gradually becoming tax-exempt," said Ben Hayllar, finance director for the City of Pittsburgh. "They [nonprofits] consume services; they don't pay any tax to support it. Everybody else pays that much more."

Hayllar helped lead a successful fight to force tax-exempt hospitals and other nonprofits to contribute to the city treasury.

No longer will a federal tax exemption be a way to avoid local taxes.

"Nonprofit institutions are going to get hit in cities across the country, particularly the ones with fiscal problems, pretty soon," said Anita A. Summers, a University of Pennsylvania tax policy expert.

"I think that fiscal stringency always means that you look at things more closely. There's been recognition for a long time that there are portions of nonprofits that are really profit-making, and local communities are not capturing this."

In Pittsburgh, 10 nonprofit organizations now make payments totaling nearly $3.5 million for city services. Five hospitals have signed up following pressure from local taxing authorities.

Ira Weiss, Allegheny County's solicitor, who has succeeded in extracting payments from several nonprofit hospitals, has been hired by other Pennsylvania communities to do the same for them. He has challenged the exemptions of Montgomery Hospital and Sacred Heart Hospital in Norristown and Suburban General Hospital in East Norriton Township. Both cases are now in court.

He also has been hired by the Unionville-Chadds Ford School District in Chester County to challenge part of the exemption of Longwood Gardens.

In Philadelphia, a committee of city officials was pulled together late last year to look at the issue. A decision on what to do about nonprofits — if anything — is expected sometime this year, said David L. Cohen, Mayor Rendell's chief of staff. "We don't know where we're going to come out here," he said recently.

Payments in lieu of taxes, or PILOTs as Cohen calls them, and services in lieu of taxes, or SILOTs, are two possibilities. PILOT would extract an annual payment from a nonprofit, instead of property taxes. Under a SILOT program, the nonprofit would agree under contract to perform a service, such as providing health care at city clinics, in return for not paying taxes.

Some nonprofits likely would resist.

"We would see that as being inappropriate for us," said John W. Gould, acting executive vice president of the University of Pennsylvania, the largest nonprofit landowner in Philadelphia. "That, it seems to me, is another way of talking about taxation."

At City Hall, Cohen acknowledges that any estimate of the value of nonprofit property is little more than a shot in the dark, because records of that property could be way out of date. "We don't spend a lot of time assessing the value of property that we don't tax," he said.

With that warning, however, city records do show that the market value of land and buildings owned by nonprofits in Philadelphia totaled $3.6 billion at the end of last year — or 12 percent of all real estate in Philadelphia.

When property owned by governments and utilities is added in, about one-third of land and buildings is off the tax rolls.

When The Inquirer asked about dozens of exempted properties last year, files on the nonprofit organizations were pulled by the Board of Revision. In some cases, the files were thin on documentation in support of the reason for the tax exemption. In other cases, the exemption of the organization went back 50 years or more.

The largest exempt group in Philadelphia is health care, such as hospitals and nursing homes. They have a market value of $1.3 billion and are exempt from $35 million a year in city property taxes.

Schools, mostly colleges, are second, with $972 million in property and $26 million in excused taxes. Religious institutions are third, with $638 million in property and excused taxes of $17 million.

Would a nonprofit flee Philadelphia if a payment-in-lieu program were imposed?

That was a factor in the planned departure of the American Society for Testing & Materials, a nonprofit group with headquarters on Logan Square.

They "asked for a letter from the mayor committing that there would be no policy to tax nonprofit institutions or to institute PILOTs," recalled Cohen. The mayor wouldn't make that commitment and, Cohen said, that was a big reason ASTM shortly afterward announced plans to move to West Conshohocken.

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Costs of the growth of nonprofit groups

Continued from preceding page

cords and interviews with economists — suggest the cost is more than $36 billion a year.

And that's conservative.

Start with the subsidy for the nation's 3,200 nonprofit hospitals. The General Accounting Office, Congress' financial watchdog, estimates that the Treasury loses at least $4.5 billion in income taxes on these hospitals. State and local governments lose an additional $3.5 billion.

Nonprofit colleges and universities avoid an estimated $4 billion in taxes.

Foundations have investment income on which they avoid payment of about $4 billion in federal income taxes.

Add the taxes lost by exempting the interest income earned by those who buy tax-exempt bonds. The Treasury estimates that figure is more than $2 billion a year.

Now add federal income deductions taken by people who donate to universities, United Way and other charities. Federal budget estimates put it at $18 billion this year.

Include the federal subsidy on mailings: about $500 million a year.

That comes to $36.5 billion a year.

The actual value of the tax exemptions is much higher. There is no way to estimate the national totals for such things as property taxes or state and local sales taxes that most nonprofits avoid paying.

Nor does the $36.5 billion include taxes waived for churches and religious groups, on which there is no reliable data.

Property tax records in Philadelphia show that the Archdiocese of Philadelphia, the largest religious property owner, holds at least $225 million in tax-exempt land and buildings, based on estimated market value. That does not include many parochial schools and colleges.

The value of the holdings of other religious denominations is harder to determine because no central organization owns them. But, based on the best information available, it is estimated at more than $400 million.

The largest nonprofit property owner in the city is the University of Pennsylvania, which owns land and buildings with an estimated market value of about $300 million. Temple University has about $275 million worth.

In all, at least $3.6 billion worth of property is owned by nonprofit groups in Philadelphia.

If property taxes were paid on it, Philadelphia would receive about $95 million a year.

And that is just one city.

States are under no obligation to grant tax exemptions just because the federal government has. But most states and local governments do.

Once in place, federal exemptions are rarely revoked. So rarely that government regulators don't keep track.

At a congressional hearing on hospitals in 1991, Treasury and IRS officials were asked how many of the 3,200 nonprofit hospitals nationwide had lost their tax-exempt standing in the last 20 years or so.

Michael J. Graetz, deputy assistant secretary of the Treasury, replied: "It's a handful of revocations, as I understand it. I think it's more than one, but certainly less than a dozen."

A minute or two later, Graetz updated his estimate.

"I think the answer ... is five, but I was not certain of it," he said.

Still later in the hearing, assistant IRS commissioner John E. Burke offered a lower estimate:

One.

■

Today, nonprofit organizations can be found running vacation travel tours, selling medical equipment, publishing magazines, hawking artwork or T-shirts or jewelry, developing retirement villages, selling life and health insurance, sponsoring business seminars, marketing videos, operating pharmacies, running testing services and managing investment firms.

The IRS relies on them to report and pay taxes on any income and profits earned on businesses that are unrelated to their core charitable mission. The IRS calls this Unrelated Business Income (UBI).

In 1987, the most recent year for which IRS had detailed data, tax-exempt organizations reported $2.5 billion in gross income from unrelated business.

About 60 percent of the groups said they had lost money on their business operations. The remainder reported $283 million in taxable profits, on which they paid income tax of $83 million.

The growing commercialism of nonprofits can be tracked in IRS data: Total taxes paid on their commercial business increased 379 percent — from $38 million to $182 million — between 1984 and 1992.

Based on their audits, IRS officials say this kind of income is often underreported.

"I don't think there's any question many tax-exempt organizations have become extraordinarily businesslike, doing things akin to the commercial sector," Owens said.

As executives of nonprofits see it, they've been forced to start for-profit businesses to provide revenue to run their exempt operations.

Their tax-paying competitors, though, say nonprofits are not merely protecting existing operations but expanding into new businesses.

Moreover, tax-paying competitors complain, nonprofit businesses have unfair advantages. If a for-profit company in New Jersey spends $500,000 on new equipment or furnishings, it pays a 6 percent sales tax, or $30,000. A nonprofit buying the same equipment pays no tax.

Such advantages have helped nonprofits gain a foothold in some businesses that have been dominated by private tax-paying firms — fitness centers, for instance.

For years, fitness centers and spas were the domain of private companies. But in the 1980s, nonprofit hospitals invested more than $500 million in such centers as they sought to develop new revenue sources.

"Every time a center like this opens, it takes away potential members from for-profit facilities like my own," said Frank J. Napolitano Jr. "We can't possibly compete fairly because they don't pay taxes and aren't regulated the same way we are. It's an enormous advantage."

Napolitano is the president of Sports Club Management Inc., an East Stroudsburg company that operates health clubs in Center City, in Bucks County and in five other locations.

In January, Napolitano came across a newspaper advertisment for The Achievement Center, a "state-of-the-art fitness facility" near his Bucks County club.

The center is affiliated with the Medical College Hospitals, a tax-exempt Philadelphia hospital group.

"I was shocked at how arrogant they were about what they were doing. Then I got angry," he said, "and I wrote them a letter asking how they justified competing with a tax-paying company. I never got a response."

The center says its programs are geared toward patients undergoing therapy. "Truth be told, we subsidize this program. We don't make money. It's part of our outreach to the community," said Meg McGoldrick, an official of Medical College Hospitals.

Commercial activities of nonprofits extend to their tax-exempt services, too. Yale economist and tax attorney Henry Hansmann, one of the nation's authorities on nonprofit organizations, has coined a term for such groups. He calls them "commercial nonprofits."

"These are nonprofits that derive substantially all of their income simply from the prices they charge for the goods and services they produce, and receive no meaningful donative support," Hansmann said at a 1987 congressional hearing.

Hansmann has recommended that Congress consider revoking the exemptions of these fee-based nonprofits, which include hospitals, nursing homes, health maintenance organizations, day-care centers and summer camps.

"The critical question is whether the nonprofits in question provide the kind and quality of service that is unavailable from for-profit firms in the same industry," Hansmann testified in 1988.

"If they do not, then the case for tax exemption is quite nebulous. At most, it will simply produce a larger volume of services ... and if this is what is desired, then we must ask why we do not extend the tax exemption to the for-profit firms as well."

One example of the kind of commercial nonprofit Hansmann is talking about is the Hazelden Foundation in Center City, Minn.

Hazelden, best known as a drug and alcohol rehabilitation center, gets 95 percent of its funds from patient fees, publishing and investments.Forty percent of Hazelden's $42 million in operating revenue in 1990 came from providing treatment. The other 60 percent came from its booming publishing business.

Hazelden officials say their publications are educational and an extension of therapy, and thus promote their exempt purpose.

The group's 1990 IRS statement shows Hazelden paid no taxes on $25 million income from book and magazine sales.

It paid self-help author Melody Beattie $1,123,389 in book royalties.

■

As large nonprofit organizations have matured, many have shed their traditional reliance on public contributions in favor of charging for their services.

In 1991, about three-quarters of the revenues reported to IRS by large nonprofits came from selling services — such things as books, educational and health services.

Public contributions, dues and government grants accounted for the remaining one-quarter of their income.

"In effect, the nonprofits are growing in economic significance, and the way they are

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financing that growth is basically through nontraditional revenues from sales and services," Frank Swain, chief counsel for the U.S. Small Business Administration, told a congressional committee in June 1988.

All but overlooked by mainstream economists, this reliance on fees and sales of services represents a fundamental shift in the nature of charities.

And it raises important questions about how and whether these organizations are different from taxpaying businesses.

Consider Lankenau Hospital, a wealthy, debt-free institution that overlooks Lancaster Avenue in Wynnewood.

In 1979, contributions were nearly 16 percent of Lankenau's revenues. That year, gifts totaled $7,855,000 of the hospital's $50 million in revenues.

For the year ended June 30, 1990, Lankenau reported revenue of nearly $119 million. More than $102 million came from patient fees. Public contributions accounted for $998,000 — less than 1 percent of all revenue.

Where did all the public contributions go? Did residents of Wynnewood suddenly stop supporting their local hospital?

Not at all.

Lankenau set up a tax-exempt foundation in 1981 to bank its public contributions, which totaled $5.5 million in 1990. This had several effects. It established a separate organization to handle the hospital's substantial investment holdings. And it made the hospital appear less profitable.

For example, in 1990 Lankenau Hospital reported a profit of $7.5 million on revenues of nearly $119 million — a 6 percent profit margin. That was double the average profit of other area hospitals. Even so, it did not reflect the actual wealth of Lankenau because it did not include nearly $13 million earned by the Lankenau Foundation on its investments.

When the profits from the hospital and foundation are combined, Lankenau's 1990 profits total $20 million. And its profit margin increased to 15 percent on combined revenue of $135,318,000.

That same year, Lankenau Hospital Foundation accumulated more than three times as much in cash — $12.6 million — as it spent on charity and other services: $3.9 million.

The $12.6 million was added to the Lankenau Hospital Foundation's already substantial investments, increasing its assets to $129 million. In 1991 those holdings increased to $137 million.

Lankenau had so much money banked in its foundation that, had it chosen, it could have cared for every patient that entered its doors in 1991 at no charge.

Lankenau spokesman Richard H. Wells said hospital trustees view the foundation's holdings as a "rainy day" fund and don't believe it would be good policy to use large amounts of the money to hold down costs.

"If we were to use the resources of the foundation to pay these expenses, the foundation would dry up or disappear rather quickly. That would not serve the hospital or the community," Wells said.

Many large nonprofit organizations provide little charity today.

In 1990, the amount of free medical care given away by nonprofit hospitals averaged 6 percent of expenditures. Some inner-city hospitals provided substantially more, but some wealthy suburban hospitals spent as little as 1 percent on care for the poor.

The charitable outlays of private colleges and universities weren't much better. In 1990, they spent an average of just 7 percent of their own funds on student aid, a computer analysis of federal data of 3,600 public and private nonprofit colleges shows.

Or consider private, tax-exempt foundations. Dominated by a few dozen huge institutions such as the Ford Foundation and the Pew Charitable Trusts, foundations controlled assets valued at $163 billion in 1991. On average they spent about 5 percent of their wealth on charitable activities — the minimum required by law.

■

In the last three decades, the very definition of charity has become blurred. Federal, state and local officials all use different — and sometimes conflicting — standards.

Since the 1960s, federal regulators have applied a broad definition of charity in overseeing nonprofits. Instead of requiring them to spend a substantial portion of their income on services to help the poor, Congress and the IRS have said that operating a hospital or school was sufficient justification alone for tax-exempt status.

Not everyone agreed with the broad definition. In 1985, the Supreme Court of Pennsylvania ruled that charities had to meet a tough, five-pronged test to justify tax exemption.

The requirements: advancing a charitable purpose; giving away a substantial portion of their services; benefiting a large number of poor or indigent persons; relieving the government of some burden, and operating free of a profit motive.

Although these standards are more stringent, they are applied only if a tax agency challenges an exemption and the case lands in court.

In some cases, the conflicts between local and federal charity standards have resulted in organizations being declared profit-making businesses by regulators at one level and nonprofit by others. The prime example is Blue Cross and Blue Shield.

Congress revoked the tax-exemption of the health plans in 1986 and started taxing them the next year. But in Pennsylvania, regulators still consider the state's five Blue Cross and Blue Shield plans tax-exempt. The state foregoes more than $150 million in tax revenues a year as a result.

The number of such discrepancies between state and federal standards is increasing. And the liberalization of charity rules may now be backfiring on federal regulators.

As more and more organizations qualify for tax-exempt status, government attorneys and revenue agents have been overwhelmed.

For years, IRS attorneys have issued formal and informal rulings to nonprofit groups as a way of providing legal guidance in difficult areas. During the 1980s, the number of such rulings slowed dramatically because of staff shortages and increasing workloads.

"We are just not reaching our cases within the time frames that we have historically set as goals. That has been a major concern," Jeanne Gessay, chief of an IRS Rulings Branch, said in 1991. "Because of the budget, we were not permitted to hire for three years."

Many of the questions IRS attorneys confront today have to do with for-profit activities of nonprofits. Under the laissez-faire policies of the Reagan administration, nonprofits shifted billions of dollars into for-profit and not-for-profit businesses outside of their exempt purposes. And Congress and the IRS were caught flat-footed by the change.

In a speech, Owens of the IRS said: "I suspect the reason for ... noncompliance is because tax advisers do not expect audit scrutiny of the organizations on whose behalf they file [tax] returns.

"Frankly, my comfort level is kind of low."

■

As for the nonprofits' comfort level, their profitability poses something of a public relations dilemma.

They have developed their own special nomenclature. They don't call their earnings "profits"; they're "surpluses" or "excesses over expenditures."

The distinction was duly noted by the Erie County judge who heard the Hamot Medical Center tax case in 1990.

Pointing out that Hamot had earned $57 million during the 1980s, Judge George Levin observed:

"Hamot contends these funds are not profit but are revenue over expenses which are reinvested in operations. The evidence showed otherwise.

"Called profit or revenue over expenses, $57 million remained after expenses from 1981 to 1989. Hamot's revenue over expenses is profit, whether Hamot chooses to call it such or not."

Then the judge quoted from a famous scene in Romeo and Juliet, Act 2, Scene 2:

"*What is in a name? That which we call a rose would by any other name smell as sweet.*"

"Profit is profit, no matter where it is spent or what it is called. This level of profit is sweet by any name."

■ **Tomorrow:** Hospitals are tax-exempt because of their charity care. So where's the charity?

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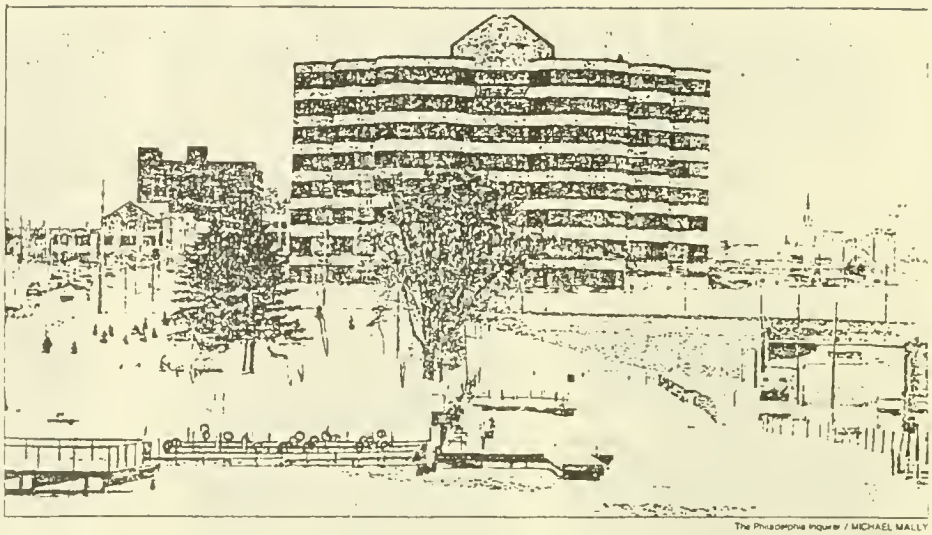
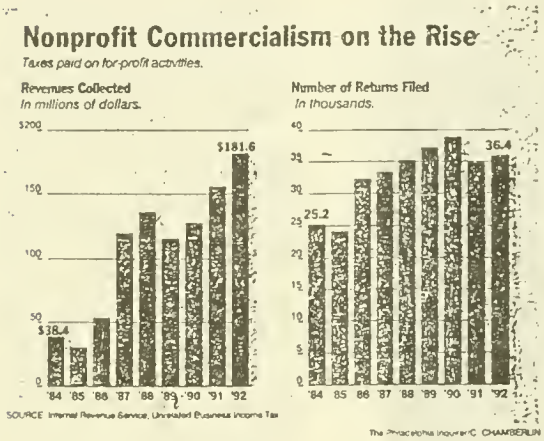
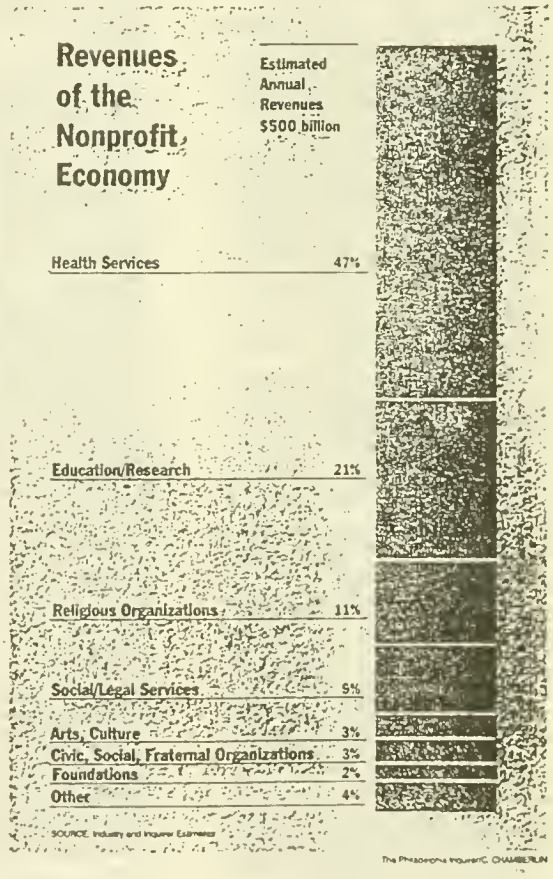
Judge George Levin upheld the County's attempt to revoke tax exemption for Hamot Medical Center because of its many for-profit businesses



Hamot Medical Center's commercial holdings included a marina near the hospital. When its tax exemption was threatened, Hamot sold the marina.

The Philadelphia Inquirer / MICHAEL MALLY





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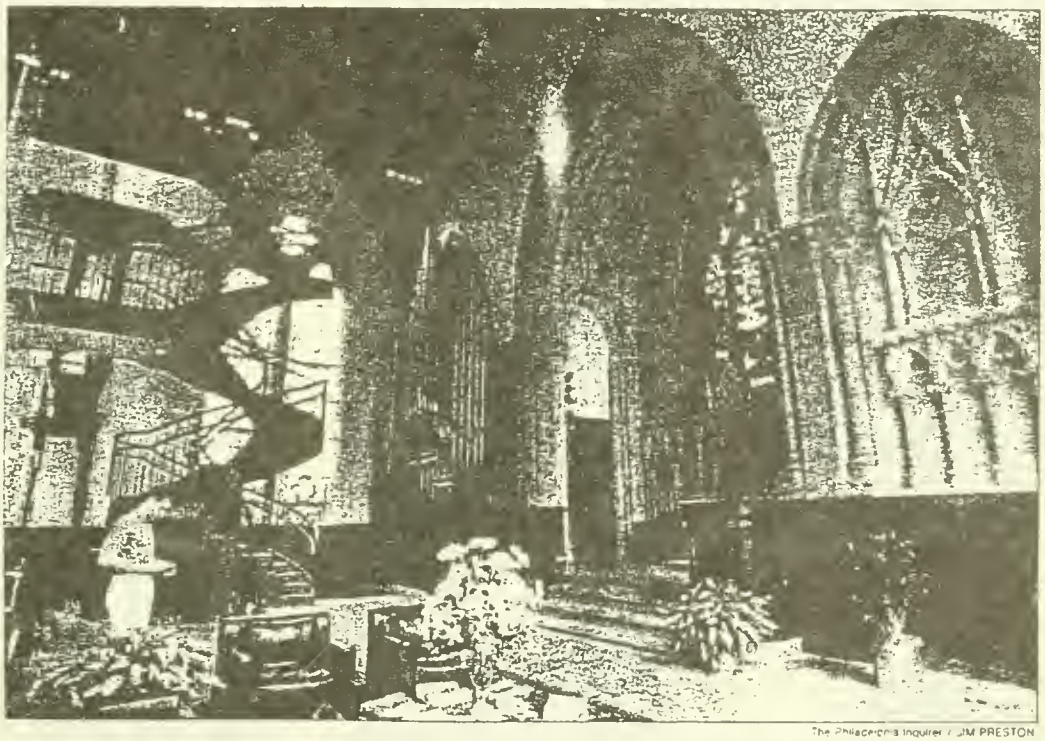
Warehouses of Wealth: The Tax-Free Economy

Second in a series.

In return for free care for the poor, hospitals didn't have to pay taxes. Now, there's less charity care. But hospitals are still exempt.



The Philadelphia Inquirer / JIM PRESTON

Graduate Health System has renovated a 112-year-old English Gothic church at 22d and Chestnut Streets for its corporate offices. The cost: $4 million. Graduate chairman Harold Cramer said it was cheaper than leasing office space.

The rise of medical empires

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS
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Graduate Hospital once was a struggling community hospital in South Philadelphia with a clear-cut mission to care for the poor and help train doctors.

Most of its beds were occupied by patients who couldn't pay. In recognition of its charity, Graduate was exempted from paying taxes.

More than a century later, Philadelphians still subsidize the hospital through their taxes. But the similarity ends there.

Today, Graduate Hospital is part of a sprawling $400 million health-care conglomerate that includes seven hospitals, a profit-making HMO, dozens of subsidiaries, 5,300 employees, a well-paid executive staff and lavish headquarters in a renovated Gothic church.

Donations, once a hospital mainstay, account for less than 1 percent of Graduate's revenue now. Most of its money comes from fees the hospital charges, just like any commercial business.

And there is relatively little charity. Less than 3 percent of its $120 million budget in 1990 went to providing free medical treatment.

Graduate is not unique. It is a case history of how hundreds of nonprofit hospitals across America, using their tax subsidies, have been transformed from small charitable institutions into modern medical empires.

At a cost of more than $8 billion a year in lost federal and state taxes.

That tax subsidy, plus others, have spurred the phenomenal growth in nonprofit hospitals. As a group, they tripled in size during the 1980s.

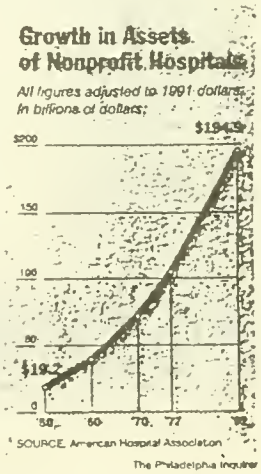
Hospitals now are the single largest segment of the $850 billion tax-free economy, accounting for nearly one-quarter of all assets. Since 1950, their assets have grown tenfold, from $19 billion to $195 billion, after adjusting for inflation.

Because they pay no taxes, many hospitals have accumulated huge profits and used them to build new hospital wings, to buy expensive equipment and to diversify into other businesses.

That has led to overbuilding and overstaffing of hospitals and has helped push health-care costs out of sight. On any given night, one-third of all hospital beds in America are empty.

In the last two decades, the average cost of a hospital stay has gone from $615 in 1970 to $1,900 in 1980 to $5,000 in 1990 — a rise of 713 percent. That

See HOSPITALS on A12



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Hospitals invest outside of health care

HOSPITALS from A1

was three times the rate of inflation.

In the same period, the revenue of nonprofit hospitals increased from about $14 billion to more than $150 billion, or four times the rate of inflation.

Despite nonprofit hospitals' tax-exempt status, their charges to patients are no lower than those at for-profit hospitals.

And charity care, once the reason for these hospitals' privileged tax-exempt status, has declined. It now accounts for about 6 percent of hospital expenditures nationwide — 3 percent in metropolitan Philadelphia.

Today, the government — or, more precisely, taxpayers — have taken over much of the charity function through such programs as Medicaid and Medicare, which have pumped more than $660 billion into nonprofit hospitals since 1965.

Nevertheless, they kept the tax exemption granted for providing free care.

Sound too good to be true?

It gets even better.

Tax-exempt hospitals no longer *have* to provide charity care.

If an uninsured worker or homeless person needs elective surgery, yet has no money, the hospital may turn away the patient without fear of losing its tax-exempt status.

That has been the government's official policy since 1969, when the IRS changed its definition of charity, in part as a result of extensive hospital lobbying.

Today, many nonprofit hospitals have accumulated huge surpluses. Most of this money has gone to grow the business.

Consider some findings from The Inquirer's 18-month examination of nonprofits:

• Hospitals have moved more than $3 billion into tax-exempt foundations and holding companies, where they have financed acquisitions, paid big salaries, and underwritten investments in for-profit businesses. One effect of these transfers is to make the hospitals appear less wealthy than they really are. Officials say the funds are used to buy equipment and replace old buildings. But little seems to flow back to the hospitals. In 1990, hospital foundations in Pennsylvania plowed back just 5 percent of their money, an analysis of tax returns of 52 hospital foundations shows. Thirty-nine percent of the money went for foundations' administrative overhead and salaries; 56 percent went into stocks, bonds and certificates of deposit.

• More than $40 billion was used to build hospital towers, offices and parking garages. At the time of this expansion, the 1980s, hospital use was declining by 13 percent. Patients are paying for this overbuilding: Between 1984 and 1988 the portion of patient bills that covers hospital capital costs increased on average from $313 to $523.

• Billions of dollars were used to expand hospitals' corporate networks. Lutheran General Health Care System, a $600 million conglomerate near Chicago, in the 1980s diversified widely, operating 65 subsidiaries, including a nationwide chain of drug and alcohol rehabilitation centers. This aggressive strategy later backfired, forcing officials to reduce the value of their holdings by $103 million.

• At least $1 billion has been invested in commercial spinoffs. Examples from the 250 hospital IRS forms The Inquirer examined include auto-leasing companies, book publishers, hotels, laundries, pharmacies, restaurants, parking lots, travel agencies, a duck hunting lodge and, in the case of the Mayo Clinic, an airport management company.

Why would a hospital invest in an airport?

"The Mayo Clinic has patients come from all over the world. To make sure they could get here, we had to have an airport," said Chris Gade, a spokesman for the medical facility in Rochester, Minn.

As nonprofit hospitals have moved farther afield, competitors and taxing agencies have become concerned.

In Allentown, a health conglomerate diversified so widely in the 1980s that it drew the attention of local tax assessors and a county judge. HealthEast Inc. had invested $5 million of hospital profits in 13 commercial businesses.

HealthEast owned a pharmacy, a telephone paging service, a medical equipment business, real estate developments, a walk-in surgical center, medical office buildings, a weight-loss program, an employee benefits' business, a computer information service, at least three private medical practices and a television production company.

"The conventional wisdom during the '80s was ... by being competitive and using competitive economic principles, you would in effect drive down the cost of health care," said Vaughn Gower, chief financial officer. "For the first time, nonprofits even allowed thinking to creep in they could be involved in for-profit activities."

In 1988 Lehigh County Orphans' Court Judge Robert K. Young decided to do an accounting of "the stewardship" of the conglomerate.

Young's study lasted more than a year. In a report in July 1990, he concluded: "The problem which must be addressed by the HealthEast Board of Trustees is a prevailing perception, unfortunately true in some respects, that HealthEast is misusing its power."

Young wrote: "If those in charge of hospitals have of late become too concerned with operating a business, as opposed to administering a charity, steps must be taken by the trustees to place the hospital back on the proper track.

"In short ... hospitals should concentrate on providing quality health care at affordable rates, and not be overly concerned with turning a profit."

Since the judge's report, HealthEast has shed at least eight of the for-profit businesses. Also its name. The nonprofit business is now called Lehigh Valley Health Network.

Belatedly, the Internal Revenue Service has begun to look more closely at the diversification, too.

"There's no question, hospitals are a good example of how some large nonprofits have changed, becoming businesslike, even investing in for-profit ventures. They present one of the most challenging areas for us," said Marcus S. Owens, director of the IRS's Exempt Organizations Technical Division.

In 1991, the IRS announced it was changing the way it audits nonprofit hospitals to take into account their increasing complexity and commercial nature. Since then, the agency has begun 23 comprehensive audits.

"I expect, based on the information to date, that we will see some revocations" of hospitals' tax-exempt status, Owens said.

■

When charity patients arrived at the hospital at 18th and Lombard Streets in Philadelphia a century ago, it was called The Polyclinic Hospital.

By the early 1920s, it had become the clinical training facility for the University of Pennsylvania's new Graduate School of Medicine, called Graduate Hospital.

But the modern history of the 103-year-old hospital begins in 1977, when the University of Pennsylvania decided to spin off Graduate as a separate corporation.

Enter Herold Cramer, a Philadelphia lawyer specializing in health care, and a small group of associates.

Under its new leadership, Graduate obtained $38 million in tax-exempt bonds to build a new patient care tower. Its revenues increased. And for the first time in years, it showed a profit.

In fact, after recording a loss of $676,815 in 1980, Graduate posted profits in each of the next 11 years. They totaled $47 million.

The profits helped underwrite a rapid expansion in the 1980s. Among dozens of subsidiaries that Graduate created were:

• X-RAY Associates Ltd., a commercial radiology business incorporated in August 1984.

• Graduate Surgi-Centers Inc., a for-profit walk-in surgical center incorporated in October 1984.

• Graduate Rehabilitation Services Inc., a for-profit physical therapy service incorporated in May 1986.

• Lombard Laboratory Inc., a for-profit joint venture with SmithKline Bio-Science Laboratories incorporated in July 1986.

• G.H. Holding Corp., a for-profit holding company for some of Graduate's commercial ventures, incorporated in August 1986.

• Mt. Sinai Radiology Inc., a for-profit company incorporated in February 1988 to provide radiology services.

• Graduate Health System Inc., a nonprofit

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management firm set up in 1988 to oversee the expanding network. It is the parent company of Graduate Hospital and its spinoff businesses.

• U/G Holding Corp., a nonprofit firm incorporated in the late 1980s to pay key executives of Graduate Health System. These salaries totaled $1.5 million in 1990, including Cramer's $350,749.

Another $4 million was used to buy and renovate a 112-year-old English Gothic church at 22d and Chestnut Streets — now corporate headquarters for Graduate Health System. The award-winning building features a great hammerbeam roof, 65-foot glass wall overlooking an atrium, cherry wood-paneled rooms and a gas fireplace in the executive offices.

Cramer, chairman and chief executive, said that purchasing and renovating the church was cheaper than leasing office space. Still, he declined to be photographed there because of concern that outsiders might look at the church "as a Taj Mahal."

Graduate's expanding network also included medical office buildings, parking lots, a sports medicine center, an occupational therapy clinic, a limited partnership to develop products for cosmetic surgery, a for-profit cholesterol control center and a for-profit company to develop new medical equipment.

Tax returns and financial records show Graduate had at least 35 corporations and partnerships under its corporate umbrella as of April 1991. Twenty-one were profit-making businesses, which are subject to corporate income taxes. Some were later abandoned.

In the late 1980s, Graduate also began to buy other hospitals and health-care providers. In 1987, as part of a nonprofit merger, Graduate acquired Zurbrugg Health Foundation, which operates medical centers in Riverside and Willingboro, N.J.

In 1988, Graduate paid $11.2 million for Mt. Sinai Hospital, a financially ailing facility at Fifth and Reed Streets in South Philadelphia owned by the Albert Einstein Healthcare Foundation.

A year later, Graduate purchased John Hancock HealthPlans Inc., a for-profit HMO with about 40,000 members. It paid $1.8 million in cash, assumed liabilities of $11.8 million and agreed to pay another $1.7 million that the health plan owed to another company. The HMO was renamed Greater Atlantic Health Plan.

In a related transaction, Graduate bought Philadelphia Health Associates Inc., a for-profit corporation that provides physician services to the HMO. It cost more than $3.6 million, including liabilities of $2.1 million. Graduate officials guaranteed payment of an $8.4 million mortgage on a medical office property as part of the transaction.

In 1991, Graduate acquired Community General Hospital in Reading in a non-cash merger, with the 164-bed facility becoming a subsidiary of Graduate Health System.

And this year, Graduate bought two hospitals from Osteopathic Medical Center of Philadelphia for $16 million, plus a $12 million note. The $16 million came from a refinancing of tax-exempt bonds.

Cramer, 65, said the many acquisitions and subsidiaries were part of a master plan to build a regional health-care network.

"That's what I have been trying to put together. We want to have a vertically integrated health-care system because we think this will allow us to provide health care for significantly lower costs than anyone else."

Under this plan, patients with less severe problems will be treated at Graduate's lower-cost suburban hospitals, while more involved cases will be referred to the more costly Graduate Hospital.

Greater Atlantic complements this strategy because it gives Graduate another source of referrals. And Graduate's many for-profit and nonprofit subsidiaries allow it to provide patients the equivalent of one-stop shopping, Cramer said.

"It's a big business, a very big complicated business," Cramer said. "But if you don't run it like a business, you won't be around to service the community."

Patients, government and private insurers are paying for Graduate's remarkable growth.

Graduate is one of the most expensive hospitals in the city, according to industry data. Between 1987 and 1991, patient revenues increased an average of 13 percent a year. That was more than twice the inflation rate.

A majority of the hospital's patients have private insurance or pay cash. The rest — 42 percent — are covered by Medicare and Medicaid, the taxpayer-financed programs for the elderly and poor. In 1991, Graduate's payments from government under these programs totaled $62 million.

Taxpayers also have helped underwrite the bulk of its expansion and acquisitions.

At least $56 million from the sale of tax-exempt bonds has been used to buy hospitals or pay back Graduate for loans and operating losses. Another $59 million in tax-exempt bonds has gone to fund equipment, buildings and parking garages.

Among the many moves Graduate has funded with tax-exempt bonds was its acquisition of Mt. Sinai Hospital. Taxpayers have subsidized this transaction in several ways.

Initially, Graduate officials used an $11.2 million bank loan to purchase the 203-bed acute care hospital. Later in 1988 they refinanced the loan with $20.2 million in tax-exempt bonds issued by the Philadelphia Hospitals Authority.

At the time, Graduate officials planned to continue operating Mt. Sinai as a community hospital, even though it had lost $13.2 million in 1987.

"Strategically what it would do is give us a community hospital," Cramer said. "It occurred at the same time my crystal ball said we should be developing a regional health-care network."

It was, Cramer acknowledges, "very risky. The losses were much bigger than we knew."

Between February 1988 and June 1991, Mt. Sinai lost nearly $32 million, according to tax returns and financial records. In 1990 alone, it lost $16.8 million.

To keep the hospital afloat, Graduate officials advanced Mt. Sinai $20 million, with most of it coming from Graduate Hospital.

In May 1989, Cramer resigned as a senior partner of Mesirov, Gelman, Jaffe, Cramer & Jamieson, his longtime law firm, to become chief executive officer of Graduate Health System. He had been its board chairman.

"The board [of Graduate Health System] asked me to do it. The Mt. Sinai situation was killing us," he said.

Graduate officials soon decided to stop operating Mt. Sinai as a community hospital. In a series of steps, they shut its emergency room, stopped doing general surgery and ended routine services. Later, they marketed the hospital as a specialty center for cosmetic surgery, drug and alcohol detoxification, rehabilitation services and psychiatric services — in effect, a boutique medical center.

A key strategy behind these moves was to attract more private-paying patients, and to maximize reimbursements from Medicare and Medicaid. The way to do this, Graduate officials decided, was to offer services that are not subject to the government's stringent payment systems.

Unlike most services, the government pays hospitals their full costs on detox, rehab and psychiatric services.

The Mt. Sinai strategy was outlined in a December 1991 document submitted to the Hospitals Authority of Philadelphia.

Continued on next page

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Charity ends when it comes to transplants

The high-tech procedures are so expensive that hospitals require patients to make sizable deposits.

The Philadelphia Inquirer / MICHAEL MALLY

Evelyn Zeller needs a liver transplant but cannot afford the $208,000 deposit. "I don't have that kind of money," her husband, Keefer Zeller, says.

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS

These days, many medical miracles carry hefty price tags. Some high-tech procedures are so expensive that hospitals won't give them away as charity.

Liver transplants, for example.

Linda Demko, a 38-year-old mother from the Pittsburgh area, learned in 1991 that her liver was so diseased she needed a transplant to survive. But Demko's husband, John, an unemployed steelworker, had no health insurance.

And the couple didn't have anywhere near the $208,000 deposit required for a transplant by Presbyterian University Hospital, a nonprofit medical facility in Pittsburgh that specializes in liver transplants.

Linda Demko died on Dec. 29, 1991, before her husband could arrange financial assistance. "She just went too fast," Demko said recently.

Bonnell Sirott, Presbyterian's associate director of finance, said, "We do not have a specific policy which provides for free transplants. However, we do work with patients to help them arrange payment."

She said the hospital had tried to get the Demkos on Medicaid. "For reasons I don't know, the Demkos didn't start this process until very late," she said.

Even having Medicaid sometimes isn't enough. In February, Evelyn Zeller of Baltimore was turned down for a liver transplant by Presbyterian officials because Maryland Medicaid would pay only 70 percent of the hospital's charges.

"As you are aware, it is the policy of the University of Pittsburgh Medical Center that a patient be both medically and financially cleared to be eligible for transplantation," Barbara Gannon, transplant credit manager, wrote Zeller on Feb. 12.

Presbyterian University Hospital is part of the University of Pittsburgh Medical Center.

"Medical Assistance of Maryland does not provide adequate payment for transplants performed at hospitals outside the State of Maryland," Gannon wrote. "The required deposit for a liver transplant is $208,000. Please be advised, however, that this amount does not represent an estimate of your total charges. You may find that your total charges significantly exceed the deposit amount."

"I don't have that kind of money and neither do hundreds of other people," said Keefer Zeller, Evelyn's husband, a pressman at the Baltimore Sun newspaper. "They do cases that make national headlines, but cases like my wife's, they turn their backs."

Evelyn Zeller, 54, is still looking for a hospital that will perform a transplant.

In November, a jury awarded $3 million to the family of another Baltimore resident, Hugh F. Wilson, after concluding that Presbyterian had denied Wilson a timely liver transplant.

The family contended that Wilson was passed over twice for an available liver, even though he had health insurance. Their suit said that hospital officials were concerned they would not get paid in full.

The hospital and the family were negotiating with insurers when Wilson died on Sept. 6, 1985.

Four days later, Dr. Thomas Starzl, a transplant specialist at Presbyterian, decried the hospital's handling of the Wilson case during a staff meeting. Notes of that session, which are part of the court record, reflect Starzl saying the case "showed an insensitivity ... as well as bad moral judgment ... in light of the money the program brings to the hospital."

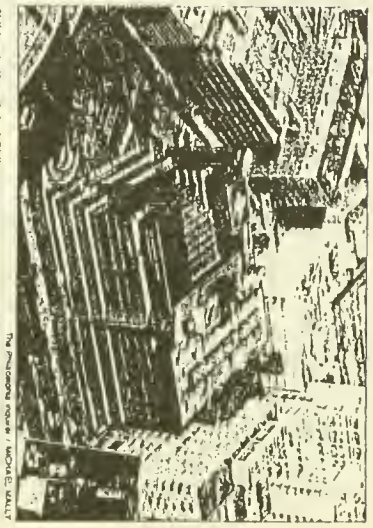
Lawyers for Presbyterian have appealed the Wilson verdict and say that Wilson was not rejected because of financial concerns. A hearing is pending.

"When it comes to medical miracles like transplants, charity often fails to survive the wallet biopsy test," said University of Minnesota medical ethicist Arthur L. Caplan. "I call it the 'Green Screen.' What do hospitals do with high-tech procedures? They make sure only those with the ability to pay get them.

"Transplantation is where the world of nonprofit and altruism intersects with the world of high prices and high profits. Organs that are donated by generous families are magically transformed into engines of profits," Caplan said.

Presbyterian spokeswoman Jane Duffield said the medical center "does provide a good amount of charity care, but not necessarily for transplants."

The hospital's IRS filing shows it gave away charity care valued at $2,620,136 in 1991. That was less than 1 percent of its $376 million operating expenses. The hospital's 1991 profit of nearly $32 million was more than 12 times what it spent on charity care.



The Philadelphia Inquirer / MICHAEL MALLY

Children's Hospital of Philadelphia has been expanding for years. In 1989, Children's opened a $48 million building for outpatient care and administration. Last year, it sold $200 million in tax-exempt bonds to renovate the hospital and build a $117 million research center and parking garage.

Growth of 5 Area Hospitals

Not adjusted for inflation.

Hospital	Revenue in millions 1980	Revenue in millions 1990	Profits Losses in millions 1980	Profits Losses in millions 1990	Net worker in millions 1980	Net worker in millions 1990	Employees earnings $28,000 in millions 1980	Employees earnings $28,000 in millions 1990
Children's Hospital of Philadelphia	$57	$296	$2.0	$18	$66	$113	29	1,042
Graduate Hospital	45	164	(0.7)	2	10	26	24	734
Hahnemann University*†	153	619	6.0	9	87	137	271	1,736
Lankenau Hospital	52	131	6.0	8	73	119	6	844
Thomas Jefferson University*	165	569	5.0	16	124	387	295	3,397

* Includes medical and graduate schools. † Figures for 1981, 1980 figures not available.

SOURCE: Hospital annual reports

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Continued from preceding page

"Mt. Sinai has an increased percentage of cost-based payers over the prior years," the document reads. "The majority [50-60 percent] of inpatient acute care and skilled nursing beds are currently exempt from the prospective payment system, resulting in decreases in bad debt and free care and other administrative adjustments."

The keys to the new Mt. Sinai strategy were to "limit competition with neighboring facilities; de-emphasize location through specialized product lines and regionalize the referral base," the document says.

The approach apparently worked. In 1991, Mt. Sinai reduced its operating loss to about $800,000. And in 1992, the revamped hospital made a $37,000 profit, Cramer said.

How does this strategy jibe with Mt. Sinai's status as a charitable, tax-exempt community hospital?

"There's a real need for these services. Our adolescent psych and geriatric rehab programs are full. And we've added a skilled nursing facility, which is also in great demand," Cramer said.

As for charity, Cramer said Mt. Sinai and Graduate System's other hospitals "never turn anyone away. We take everyone who shows up ... including AIDS patients who other hospitals send us by cab."

For taxpayers, the Mt. Sinai saga doesn't end here.

In late 1991, Graduate sold $112 million in tax-exempt bonds through the Hospitals Authority of Philadelphia as part of a system-wide refinancing.

According to an offering statement, bond proceeds were to be used to refinance earlier debts; fund various capital projects, including an underground garage; and pay back Graduate Hospital and Graduate Health System the $20 million they had advanced Mt. Sinai to keep it afloat.

Ordinarily, tax-exempt bonds are used to pay for new hospital construction, not to insulate a hospital from the consequences of an investment gone bad.

Yet, in this instance, that is what took place. Graduate officials were able to recoup a substantial portion of their operating losses at Mt. Sinai — and to do it with the help of the public, whose taxes make up for the interest lost on tax-exempt bonds.

Cramer said using tax-exempt bonds to pay back Graduate is not unusual. "Federal policy allows for it. This is not something that was created for Graduate," he said. "This is not something I'm borrowing and am not able to pay back."

In essence, the risky Mt. Sinai purchase became a risk-free venture — thanks to taxpayers.

■

For years, hospitals earned their tax exemption by giving away a substantial amount of care.

Until 1969, they were required to provide free medical care to the extent of their financial resources — what was known as the "financial ability" standard.

It reflected the long-held position of the government that charity should benefit the poor, not an indefinite class of people.

In 1969, IRS officials dropped the financial ability standard in favor of a "community service" standard, which defined charity in broader terms. Hospitals now qualified as tax-exempt charities because they promoted health services for their communities.

"Like the relief of poverty and the advancement of education and religion [the provision of health care by hospitals] is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole, even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community," the IRS ruled.

In other words, just being there is enough — whether poor people are helped or not.

Nonprofit hospitals had been lobbying for such a change for years. In discussions with IRS officials and testimony before congressional panels, hospital officials contended that most Americans had government or private health coverage. There just weren't that many charity cases, they said.

In 1968, Congress appeared to be on the threshhold of passing legislation adopting the hospitals' point of view. But differences between House and Senate committees over an acceptable definition of charity proved irreconcilable, and the issue was dropped.

Enter the IRS.

The tax agency also had been studying the issue and interviewing hospital administrators. Rather than wait for Congress to pass a law, IRS rewrote its own regulations, loosening its definition of charity.

"They accepted the hospital industry's point of view that there was no more charity problem," said Daniel C. Schaffer, a professor of tax law at Northeastern University. "On the basis of their representations, the service decided to discharge hospitals of their responsibilities."

Schaffer said IRS attorneys believed that Medicaid would cover most uninsured and indigent Americans. Again, that's what the hospitals had said.

In fact, Medicaid never came close to covering all of the nation's poor.

Congress left it up to individual states to set the financial eligibility criteria. Most states set them so stringently that the standards excluded many of the poor.

Today, 28 years after Medicaid's enactment, the program covers fewer than half — 49 percent, in fact — of the estimated 32 million Americans living below the poverty level.

Despite such glaring holes in the nation's health-care safety net, the IRS did not revisit its 1969 charity decision until Congress raised the issue in 1991. Even then, Michael J. Graetz, an assistant secretary of the Treasury, said there was no reason to change.

"A community benefit standard reflects the longstanding proposition that the promotion of health is a charitable purpose and recognizes the potential for a variety of means of fulfilling that purpose," he told the House Ways and Means Committee in 1991.

In an interview, Schaffer was more blunt: "The IRS has basically been in denial for the last quarter-century. It's as though they turned their heads so they wouldn't see what was happening. It's disgraceful."

Congress did not hold follow-up hearings on the IRS's 1969 decision. Nor did it examine the link between charity care and the tax breaks awarded nonprofit hospitals until Rep. Brian J. Donnelly (D., Mass.) and Rep. Edward R. Roybal (D., Calif.) introduced bills to tighten charity care standards in 1991. Neither proposal advanced past the committee stage.

"It's very difficult politically to raise these issues. Hospitals are very powerful and have an array of lobbyists," said Donnelly, who retired in January after 16 years in Washington. "You don't get any votes for taking on the hospitals."

"Congress was asleep on this issue," said Daniel M. Fox, president of the nonprofit Millbank Memorial Fund and a colleague of Schaffer's. "It allowed the IRS to set both tax and health policy and then provided no oversight. For the last 20 years, hospitals have essentially had a free ride."

■

It has been a great ride, unmatched by all but a handful of other industries.

At a time when many businesses have been in retreat, shutting plants and laying off workers, the hospital industry booms:

• Hospital employment more than doubled nationally, from 1.8 million workers to 3.7 million, in the last two decades — making it one of the economy's most dynamic performers.

• In metropolitan Philadelphia, hospital employment climbed from 78,700 in 1979 to 111,200 in 1991. About half these employees work in the city, where they received $1.7 billion in wages and benefits in 1990, according to the Delaware Valley Hospital Council.

• Hospital wages more than tripled between 1977 and 1990 — to $70 billion. That was double the general rate of inflation.

And those rising wages are one of the key factors in higher health costs.

The number of Americans reporting income between $30,000 and $40,000 rose 48 percent in the 1980s.

The number of nonprofit hospital employees reporting income over $30,000 rose 10 times as fast.

At specific hospitals, the growth was more dazzling:

At Thomas Jefferson University, the number increased from 295 to 3,307 employees.

At Pennsylvania Hospital, it increased from 57 to 1,027.

At Children's Hospital, the number swelled from 21 to 694.

At Graduate Hospital, it rose from 24 to 657.

"Hospitals are the new steel mills of the '90s," said Tom Chakurda, spokesman for Allegheny General Hospital, which runs five hospitals in Philadelphia. "Officials sometimes overlook that when they go looking for hospitals to pay taxes."

The reason for such dramatic increases lies in the changing nature of hospitals. With the adoption of ever-more complicated technology, their need for more highly skilled workers has grown.

Today, more than 65 percent of nurses in hospitals are registered nurses, who typically earn between $35,000 and $65,000. That's up from 49 percent a decade ago.

Increased demand for therapists and technicians also has pushed up salaries. And salaries of hospital administrators now often exceed executive pay at comparable-sized companies.

All of this — spurred by the enormous growth of tax-exempt hospitals — has helped drive up prices. It is the health-care monster that the White House task force is trying to wrestle to the ground.

In a report issued in January, the U.S. Commerce Department cited the labor intensity of the health-care industry and the high earnings for professional, administrative and technical workers as the most important reason medical expenditures increased by 11.5 percent in 1992 to $838 billion.

■

Perry J. Leon, 64, of Northeast Philadelphia has strong views about such costs.

In November 1991 Leon was charged $6,373.50 for an operation to remove a cataract in one eye. The outpatient procedure at Rolling Hill Hospital lasted "about one hour," Leon said. Including recovery time, he spent five hours at the hospital.

Leon's insurer, Travelers Insurance Co., paid the hospital $5,576.50. The hospital billed Leon for the balance. He refuses to pay.

"The hospitals are committing a crime against the sick, and this has an effect on the nation's economy, on working people and unions," Leon said. "I'm lucky. I have insurance through work. But lots of people don't."

"How a one-hour procedure on one eye can cost so much is fantasy. That's what I told them. I said, 'This is a fantasy. I am not going to pay. If you want to go to court, let's go.' It's been more than a year and I haven't heard from them," he said.

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Hospital officials say criticism like Leon's is unfair. Yes, their costs are high, but that's because of the sophisticated procedures and elaborate technology. Instead of criticizing, patients and politicians ought to be thankful for the important role hospitals play in the economy, they say.

"One in every eight workers in the Delaware Valley owes his or her job to hospitals," the Delaware Valley Hospital Council said last year. Citing a $40,000 study paid for by the council, it said hospitals contribute more than $5.5 billion a year to the economy.

"Hospitals are to the Delaware Valley what cars are to Detroit," said Hospital Council president Jeff Flood.

Indeed, hospitals are an important economic force in the region. But their tax breaks are based on their charitable community service, not the jobs they provide.

And the profits that some have accumulated makes it hard to argue persuasively that they are trying to control costs.

Consider these examples from tax filings with the IRS for the years 1989 through 1991:

• The Mayo Foundation in Rochester, Minn., owned $531 million in stocks, bonds and securities and controlled property worth, $773 million. In 1986 and 1987, Mayo accommodated patients who were retiring to warmer climates by building a $27 million clinic near Jacksonville, Fla., and another $65 million facility in Scottsdale, Ariz.

• The Cleveland Clinic Foundation held $207 million in cash and investments, plus property worth $627 million. Clinic officials opened a $150 million satellite facility in Fort Lauderdale in 1987. They, too, said they were following their patients south.

• The Methodist Hospital System in Houston held investments worth $600 million and property valued at $408 million. Among its many investments: the Chez Eddy, a self-described "highly acclaimed gourmet restaurant," and a duck lodge, since sold. Between 1986 and 1990, its diversified holdings generated $100 million, yet only $3 million was returned to the hospital. Meanwhile, the hospital's prices rose an average of 7 percent a year.

• Thomas Jefferson University in Philadelphia had investments worth $247 million and owned property and equipment worth nearly $356 million.

• Main Line Health System, which includes Bryn Mawr, Lankenau and Paoli Hospitals plus 21 other affiliates, held $230 million in investments and $411 million in property.

• Children's Hospital of Philadelphia and its affiliates owned nearly $190 million in stocks, bonds and other investments, plus $175 million in property and equipment.

Like other hospitals, Children's has used its surplus to expand rather than hold the line on patient charges. Those keep going up, averaging 7 percent a year for the last five years. Says Children's President Edmond Notebaert, "Our increases have been lower than those of other comparable hospitals."

In 1989, Children's opened a $48 million building for outpatient care and administration. Last year, the hospital sold about $200 million in tax-exempt bonds to renovate Children's Hospital and build a $117-million research center and parking garage.

The hospital said it would contribute $69 million. Patients and taxpayers will pay for the rest in at least five ways:

Patients will pay higher charges to help cover increased overhead and debt; federal tax dollars will underwrite much of the medical research; investors who buy the hospital's tax-exempt bonds will receive tax breaks, resulting in a loss to the Treasury; a low-interest $9 million loan from the state will help pay for the project; and the new research facility will be off the city's property tax rolls, which means the public will shoulder a larger share of the tax burden.

How much charity care do nonprofit hospitals provide? Does it equal the value of their $8 billion tax exemption?

The American Hospital Association says that hospitals provided $8.9 billion worth of free treatment in 1989.

"The problem is one in which we are seeing the indigent and the uninsured patients that are showing up at our hospitals at a greater and greater number, with nowhere to shift that cost," Jack W. Owen, acting president of the American Hospital Association, told Congress in July 1991.

But some critics say the hospitals' figures are inflated, because they include bad debt and other costs that are not charity.

"The hospitals are playing with the numbers, and in some cases their charity care doesn't come close to the value of their exemption," said Donnelly, the former congressman.

A 1990 study of nonprofit hospitals in five states by the General Accounting Office showed that 57 percent provided less charity care than the tax benefits they derived.

Overall, industry data show charity care accounts for about 6 percent of nonprofit hospitals' budgets. In Pennsylvania, the average is about 3 percent.

Those numbers have declined.

In 1986, hospitals spent on average 6.5 percent of their budgets on charity care, the American Hospital Association says. By 1990, the number was 5.9 percent. In Pennsylvania, it fell from 3.5 percent to 2.9 percent, according to the Hospital Association of Pennsylvania.

Some spend even less. Methodist Hospital System in Houston made a combined profit of $76 million in 1991, and gave away $5 million in charity care — or 1 percent of its gross patient revenue. Its federal, state and local tax exemptions were worth $36 million.

In the five-county Philadelphia area, hospitals say they provided more than $169 million in charity care in 1991, including nearly $127 million in Philadelphia. They say these easily dwarf the estimated $80 million in property taxes they are excused from paying.

That's only one of their tax exemptions, however. And the $127 million includes bad debt — uncollected bills that the hospitals contend is charity.

In Philadelphia, which has more poor than any other county in the state, over 96 percent of all care is paid for by patients, insurers and government. Only 3.6 percent of hospitals' $3.5 billion in expenses went for charity.

"The fact is, there aren't many charity cases in the hospitals. [Patients] are paying for almost everything," said Allegheny County solicitor Ira Weiss, who won settlements in lieu of taxes from several Pittsburgh-area hospitals.

"Most nonprofit institutions were founded by philanthropic people to take care of the poor. But I'm afraid the old brahmins would be rolling over in their graves if they could see some of these hospitals today," Donnelly said.

"The days of the nonprofit hospital are over. They are vestigial institutions whose nonprofit form no longer has meaning," said Henry Hansmann, an attorney and economist at Yale University who has written extensively about tax law and hospitals.

"As a matter of tax policy, we may not want to do away with nonprofit hospitals, but that doesn't mean we still want to subsidize them."

■ **Tomorrow:** Tax-exempt private colleges make millions on investments in the 1980s — while doubling tuition.

The Philadelphia Inquirer / MICHAEL MALLY

Under chairman and chief executive officer Harold Cramer, Graduate Health System Inc. has grown into a regional health-care network. "It's a big business, a very big complicated business," Cramer said. "But if you don't run it like a business, you won't be around to service the community."

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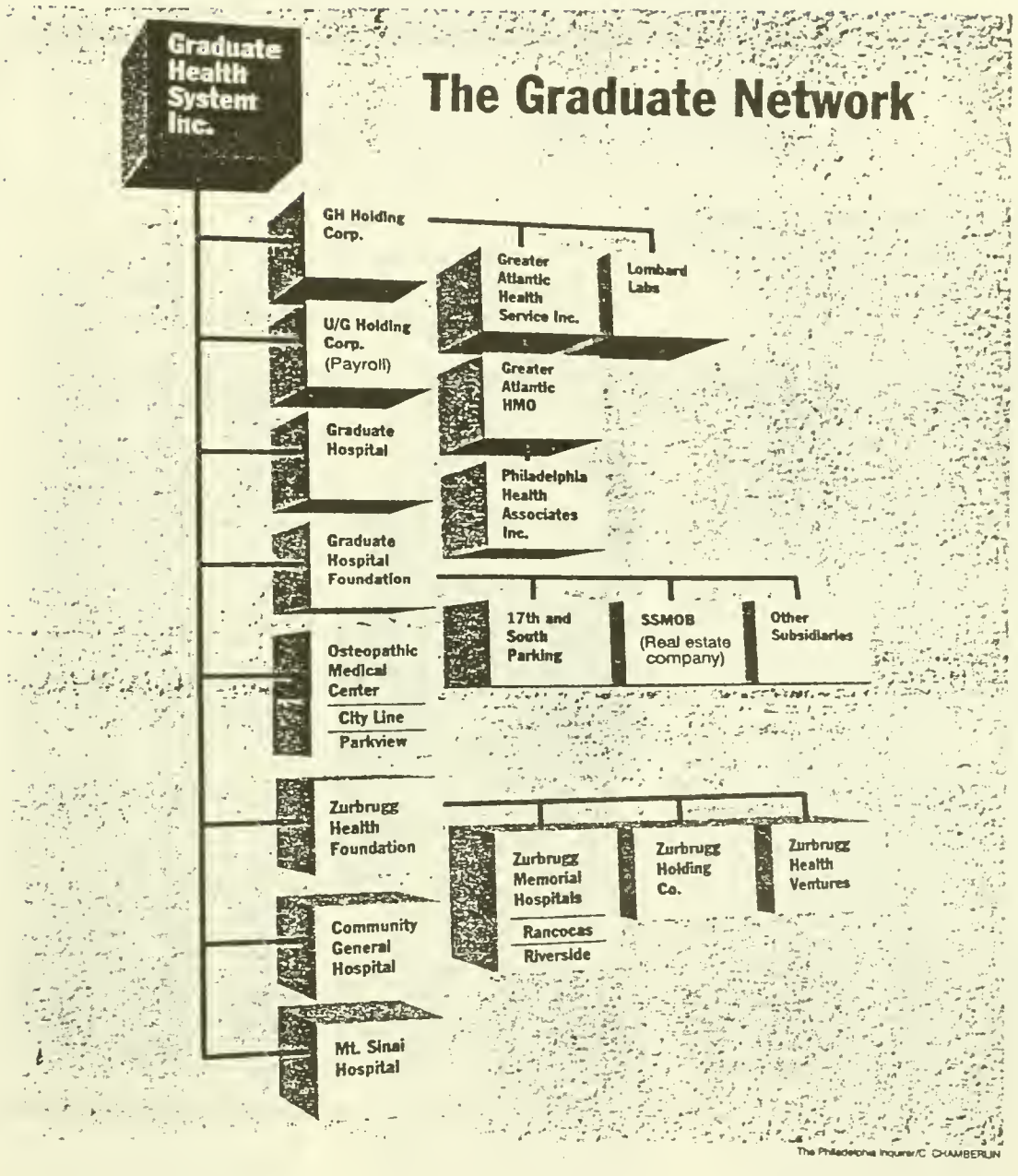

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Warehouses of Wealth: The Tax-Free Economy

Third in a series.

While colleges stockpile millions every year from investments and research, tuition climbs out of the reach of more and more Americans.

A tax break colleges can bank on

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS
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It was cold in the Squam Lake boathouse in New Hampshire where they gathered that June morning four years ago. Even after the meeting was moved to a warmer room, a chill hung over the conversation.

What would happen, one of them fretted, if the public found out about their meetings? Could they be accused of collusion?

Indeed they could, another suggested. All it would take was some hot-shot government lawyer trying to make a name for himself. Things could get ugly fast.

Corporate raiders plotting a takeover? Wall Street insiders?

Try college admissions officials.

They had met at the boathouse — officials from Harvard, MIT, Yale, Brown, Amherst, Dartmouth, Bryn Mawr, Smith, Mount Holyoke and Wellesley — to compare notes on how much financial aid they would offer to selected students. Their purpose, as it has been for 30 years, was to avoid competing for the same students by offering better deals.

They called it an "overlap meeting."

A federal judge called it conspiracy to fix prices. And ordered them to stop.

Antitrust lawsuits, hush-hush meetings and soaring prices may seem more like big business than higher education. But these days, higher education is big business — more than $140 billion a year.

It is also a profitable business. Some private colleges and universities bank $100 million a year after expenses. One has amassed investments of $5 billion.

Some schools have become virtual research factories, under contract to private industry and government; they have spent heavily on buildings, high-tech labs and high-priced scientific and technical talent. Others have invested widely in commercial businesses, including spinoffs from academic discoveries.

All this has helped drive up the price of a private college education in the last decade by 151 percent. That's 2½ times the rate of inflation.

Room, board and tuition at a private university today can cost $25,000 a year. That would just about wipe out the after-tax income of the median American household.

Eighty years ago, Congress exempted colleges from paying taxes to foster and encourage education. Lawmakers also believed a system of private schools would relieve the government of some of the burden.

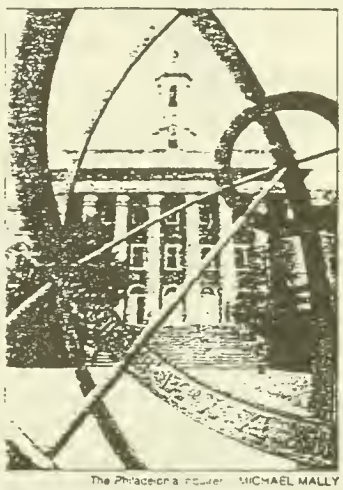
Today, these tax breaks are worth an estimated $4 billion a year.

But increasingly, taxpayers who help underwrite this subsidy — which is to say, all taxpayers, of however modest means — are seeing their own children priced out of the private college market or forced to absorb debts as high as $100,000.

As private universities have grown, they have changed in fundamental ways from the schools Congress exempted from taxes early in the century. Consider these findings from The Inquirer's 18-month study of the nation's tax-free economy:

- At some schools — including MIT, CalTech and Penn State's main campus — more is spent on research than on instruction. As a result, some professors spend more time overseeing government and private contracts than they spend in the classroom.
- Colleges use taxpayer-subsidized facilities to help profit-making companies develop new drugs, cars or computers, which then are sold to the public at big profits. The schools pay no taxes on this commercial income from their research and engineering work, and the companies get an R & D tax

See COLLEGES on A6



The Philadelphia Inquirer / MICHAEL MALLY

At Pennsylvania State University's main campus, more money is spent on research than on teaching.

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For colleges, making money is academic

COLLEGES (from A1

credit.

• Some schools have become venture capitalists, investing in risky, start-up firms. For example, Boston University has an investment of $75 million in a Massachusetts biotechnology firm, Seragen Inc., which hasn't shown a profit yet and may never make money, according to Seragen.

• Schools have expanded the definition of education to engage in such commercial activities as catering, operating hotels, sponsoring trips abroad, running seminars and retreats, marketing computer software and selling videos featuring star professors.

• Raising money has become a full-time business at many large schools. Princeton University boasts that its "fund-raising machine" brings in $1.7 million a week. Between 1981 and 1992, Princeton's endowment more than tripled and now totals $3 billion — enough to pay for tuition for its 4,550 undergraduates for the next 35 years.

• Sports programs at many large universities have become thinly disguised businesses, with multi-million-dollar television contracts, highly paid coaches, corporate sponsor deals and commercial endorsements.

• Universities are the largest private landowners in many cities. In Philadelphia, tax-exempt educational institutions own nearly $1 billion in land and buildings that are not subject to real estate taxes.

• Growing numbers of colleges and universities compete with taxpaying companies, supplying services that range from testing samples under a $1 million electron microscope to running simple laboratory blood tests. Owners of businesses say the schools have an unfair advantage because they don't pay taxes and use university facilities.

Just how prosperous some have become was pointed out by U.S. District Judge Louis C. Bechtle in Philadelphia, who heard the Ivy League price-fixing case.

Bechtle ruled last September that Massachusetts Institute of Technology violated the Sherman Antitrust Act by conspiring to control tuition prices in the case involving the financial-aid meeting at the boathouse in New Hampshire. Only MIT fought the case in court; the other colleges agreed to stop meeting after the Justice Department sued.

First, the judge had to decide whether a university, such as MIT, was subject to antitrust laws, like any business. Yes, he decided, because it engages in commercial activity.

"That MIT is a significant commercial entity is beyond peradventure," he wrote. "The magnitude of MIT's economic activity is certainly far greater than that of the vast majority of businesses."

A $1.2 billion operating budget. Securities investments of more than $1.3 billion. Revenues from tuition of $158 million a year. Profits totaling $126 million.

MIT defended the sharing of financial aid information by maintaining that the aid was charity, not commerce. Judge Bechtle didn't agree:

"Although MIT characterizes its financial aid as 'charity,' in essence MIT provides a 'discount' off the price of college offered to financial aid recipients. By agreeing upon aid, the Ivy Overlap Group schools were setting the price" these students would pay for an education.

"The court can conceive of few aspects of higher education that are more commercial than the price charged to students," he wrote.

The price is soaring.

At MIT, tuition alone stands at $18,000 a year. It rose nearly 10 percent a year between 1981 and 1991. The Ivy League schools — Penn, Harvard, Princeton, Dartmouth, Yale, Brown, Cornell and Columbia — more than doubled their prices in the decade.

Harvard, the wealthiest school with $5 billion in savings, charges $23,514 a year for tuition, room and board.

The U.S. Department of Education has reported that in the 1980s the average cost of tuition at a private college increased 151 percent, from $3,498 a year to $8,772 a year. The average cost of tuition at a public college rose 129 percent, from $635 a year to $1,454.

During the same period, median family income of Americans increased 73 percent, or half as much as college costs. Inflation rose 59 percent in the 1980s, less than half the increase in college tuition.

"It would be difficult to find a commodity or a service that rose faster than higher education costs," said a report last fall from the U.S. House Select Committee on Children, Youth and Families.

Almost nine out of 10 Americans in 1991 believed increasing costs would put a college education out of reach for most people, a Gallup Poll found. "This perception — that college soon will be unattainable for most citizens — is an ominous sign that threatens the basic fabric of American education and society," the National Commission on Responsibilities for Financing Post-Secondary Education said earlier this year.

Tuition increases came as many of the wealthiest private schools were becoming wealthier. Endowment funds at the Ivy League schools nearly tripled in the 1980s, growing at an average annual rate of 11 percent, during a time of 4 percent inflation.

As they were raising prices in the 1980s, college officials were aware of the implications. MIT Provost Paul Gray attended a meeting of Ivy League college presidents on Dec. 7, 1983, according to his handwritten notes that are part of an exhibit in the government lawsuit against MIT.

At the meeting, presidents of the Ivy schools and MIT shared their anticipated percentage tuition increases with each other. Most were between 7 percent and 8 percent. "Some concerns expressed," Gray wrote in his notes. "(1) Are we pricing ourselves out of the market?" and "(2) Increase at 7-8% level will bring public criticism."

Those concerns did not stem the increases, though.

The Ivy League schools boosted tuition an average 9 percent a year between 1981 and 1991. In 1981, it cost $6,200 a year to attend MIT's classes, not including room and board; by 1991 that price had risen to $15,600. It goes to $18,000 this fall.

At Princeton, tuition will be $18,940 this fall. With room and board, the cost rises to $24,650. A family paying for a child's Princeton education would be sending out a check for at least $2,054 a month for four years.

As Harvard President Neil L. Rudenstine said at the National Press Club in November: "I seriously doubt that anything that costs more than one-third of a family's annual income, especially when you have to do it four years in a row, is what we would call 'affordable' in any usual sense of the word."

What accounts for these steep increases? Higher salaries and expanded campuses, college officials say.

And administrative bloat.

"Undetected, unprotested and unchecked, the excessive growth of administrative expenditures has done a lot of damage to life and learning on our campuses," American University economist Barbara R. Bergmann, former president of the American Association of University Professors, wrote last year. "On each campus that suffers from this disease — and most apparently do — millions of dollars have been swallowed up."

■

The fastest-growing profit center at many large universities today is research.

Consider Penn State University, a land-grant university that gets 17 percent of its $1.5 billion budget from the state.

Penn State is second only to MIT in contracts performed for private industry — $35 million a year. MIT makes $43 million.

Total research contracts, both commercial and government-funded, in 1990 brought in $257 million, ranking Penn State ninth in the nation, after Texas A & M and before UCLA.

At any given time, Penn State is working with 400 companies on 600 projects. Many of the relationships are confidential at the companies' insistence, the university says.

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"Nearly 100 research and development centers are housed within the university, many of which involve partnerships with industry," touts one of its promotional brochures.

Researchers in one laboratory are at work for IBM Corp., trying to make computer fans run more quietly. Their research is based on earlier Penn State work for the U.S. Navy on making submarines run silently.

At another lab, researchers are working for a consortium of 20 companies to develop processes to coat ceramics with layers of crushed diamonds for grinding and other industrial applications.

Yet another lab is working on the proteins given off by the roots of the Chinese medicinal cucumber. The Chinese have long used cucumber extract to induce abortions; researchers believe it also holds promise in fighting AIDS. Penn State is trying to interest drug companies in backing the project.

For large universities, such research jobs for industry can mean huge sums — Penn State collected nearly $147 million between 1987 and 1991.

Tax benefits abound.

Universities pay no taxes on most of this research revenue. Companies subcontracting research to a university get a research and development income tax credit. And much of the equipment and technology were underwritten by state or federal dollars.

The American taxpayer thus foots much of the bill, directly or indirectly.

The university also benefits from its own research discoveries through licensing fees and royalties on patents. This revenue also is free from taxes.

It is no wonder, then, that universities are spending more of their resources to qualify for contracts. At Penn State's main campus, research expenses were 30 percent of the campus' $179 million in expenditures in 1990, according to U.S. Department of Education data. That was more than the proportion devoted to instruction: 28 percent.

Between 1981 and 1991, research and development spending at universities rose from $6.8 billion to $17.6 billion, according to the National Science Foundation. Research spending grew an average 10 percent a year.

Industry-sponsored R & D grew even faster — 15 percent a year. The R & D work done for businesses nearly tripled, from $294 million to $1.22 billion. Universities collected $7.8 billion between 1981 and '91 from companies.

For companies, there are advantages beyond just the tax incentive. If a well-paid Ph.D.'s research is less than satisfactory, the university researcher simply doesn't get another contract. It's not that easy with a company's own research staff.

And although companies pay for the research, they don't have to build the facilities, pay for the training, or increase their in-house R & D. The universities absorb those costs.

As this commercial income was pouring into Penn State in the 1980s, tuition was increasing an average 9 percent a year. Undergraduate tuition for a state resident today is $4,548 a year — more than double the tuition in 1981.

About 14 percent of the research done at Penn State is for industry — twice the average for the 20 largest research universities. The balance is state and federal contracts.

And the research business is expected to expand even more, as America's largest corporations downsize and cut into the budgets of their in-house R & D departments, said David A. Shirley, Penn State's senior vice president for research. Shirley moved to State College in 1992, after serving as director of the government's giant Lawrence Berkeley Laboratory in California.

He expects the industry share of Penn State's research could reach 30 percent in the next decade. The college has an all-out marketing program to attract businesses.

By the end of this year, the first buildings will open at a 130-acre, $65 million research park near campus. Corporate tenants are being sought for the park, which will include a 150-room hotel and 1,200-person conference center. Much of the project is to be financed by tax-exempt bonds issued on behalf of the university.

Will Penn State begin to pay taxes on the millions it collects for doing research?

"I never thought of research as being taxable," Shirley said. "I don't think of it as a business activity. I think of it as part of the educational process."

In fact, there's a shortage of qualified graduate students to aid the research, he said. The university is considering increasing scholarship money to attract more.

■

Charles A. Garber says they've gone too far.

The president of a commercial testing laboratory in West Chester, Garber has waged a continuing war against nonprofit, tax-exempt laboratories that are luring business away from tax-paying firms.

He and others contend that some universities are competing directly with tax-paying businesses for routine laboratory work, such as water testing or material analysis.

Garber formed Structure Probe Inc. in 1970 to analyze materials for clients under an expensive electron microscope. Last November, a newsletter from the Philadelphia Electron Microscope Society caught his eye. Near the employment opportunities announcements was this "Services Available" notice:

"A large university EM [electron microscope] facility is making their services available for contract use. Instrumentation includes a JEOL 330A SEM with Kevex microanalytical system and a TEM. For information, please contact ... "

Although the ad didn't name the university, the electron microscope lab is at the University of Pennsylvania and the notice was placed by two researchers, who included two telephone numbers at the university.

"Unfair? Of course!" Garber said in a letter to the newsletter's editor. "The university has its equipment purchased for it by the taxpayers of the United States, either directly or indirectly.

"It was put there for educational purposes only, and it certainly was not put there to be used as a commercial business, and in direct competition with for-profit tax-paying firms," he wrote. Copies were sent to Penn president Sheldon Hackney and to Garber's congressman and state representative.

The Penn staff members who were soliciting business have been told it is university policy not to compete with for-profit businesses, said Phyllis Holtzman of Penn's news and public affairs office.

"A nonprofit has its tax-exempt status because it is to serve the public," said Earl H. Hess, chief executive officer at Lancaster Laboratories Inc. "When that [tax exemption] is taken and twisted around to compete against the commercial marketplace, that's where we run into trouble."

Hess also has been battling nonprofits. His testing lab in Lancaster was founded in 1961 and has 500 employees. He said there were many instances over the years in which universities competed with his firm for both commercial and government contracts.

"I wonder how that is fulfilling their mission," he asked.

Entrepreneurs in private business are finding that universities with tax exemptions, state funding and "what amounts to slave labor" in graduate students working in university labs are showing up as bidders competing for the same contracts, Hess said.

At Structure Probe, Garber maintained that Penn State also has crossed the line.

"Penn State is moving in a direction that sort of obscures the line that separates what a business should be doing and what a university should be doing," Garber said. "The taxpayers are subsidizing what Penn State is doing and a private company couldn't be profitable competing against that."

Garber, who opposed Penn State's activities in congressional testimony and in letters to the state legislature, said university research should be limited to basic and fundamental research with new discoveries as the goal.

In November, Garber complained to State Rep. Elinor Z. Taylor of West Chester that Penn State's Low Level Radiation Monitoring Lab was offering a commercial service. He included a Penn State letter to a Princeton company soliciting business, with prices attached. The price list notes that "customers may request their samples be given higher priority to ensure a faster turnaround time."

"Please consider contacting our lab when you need radiological monitoring services," says the solicitation letter.

"This is just plain outright wrong and is something that absolutely should not be getting done at a taxpayer-supported institution like Penn State," Garber told Taylor. "As usual, it is the small businesspeople who are going to be hurt the most when Penn State deviates from its chartered purposes and operates a business/commercial activity."

Taylor passed Garber's complaint to Penn State. "I think he has a legitimate concern," she said.

The lab "has always been conscious of a potential adverse impact on commercial operations," Marcus H. Voth, director of Penn State's Radiation and Science Engineering Center, responded.

Voth described the lab as a "self-supporting entity." He said "charges for analytical services have paid the staff salaries, purchased new laboratory equipment, and paid for supplies, materials, equipment maintenance and other operating expenses. The laboratory has simultaneously been used for academic research. The marriage between a cost-recovery public service and academic research has benefited both programs."

Many private firms don't have the expertise or equipment to test radioactivity levels in water, Voth said in an interview. Full-time technicians perform the tests in the lab and students are not involved, Voth said.

Like other programs under the research umbrella, revenues at the lab are tax-exempt.

■

When state officials last year proposed eliminating the $15.3 million state allocation

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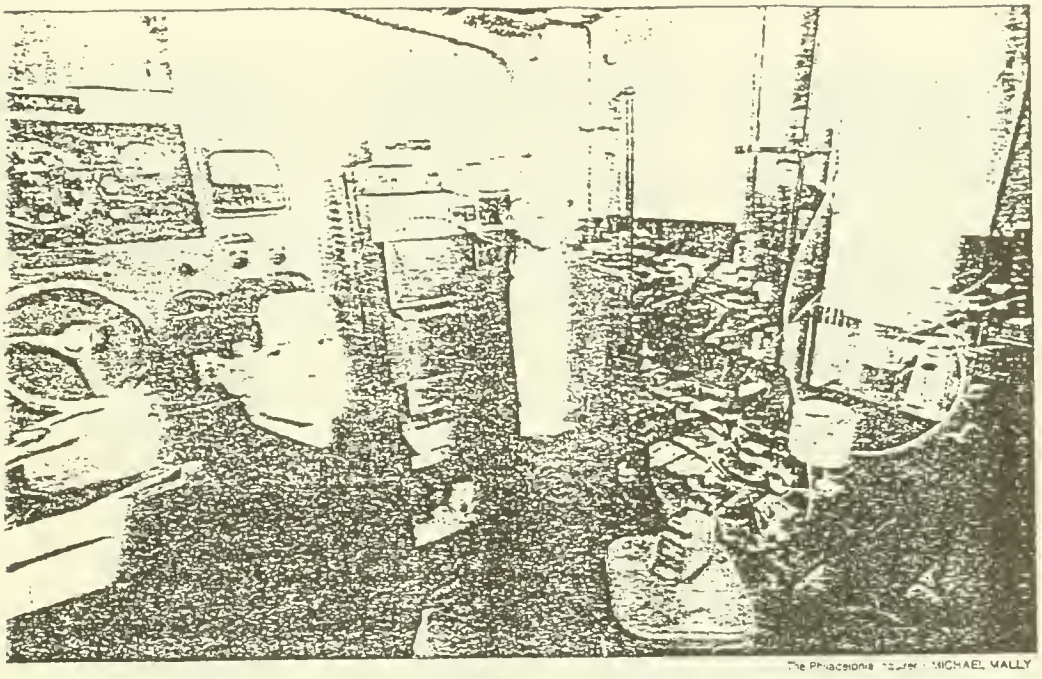

The Philadelphia Inquirer / MICHAEL MALLY

With funding from Texaco, Penn State professor Thomas A. Litzinger (right) and graduate student Stanley L. Bower Jr. are studying internal combustion engines. At any given time, Penn State is working with 400 companies on 600 projects.

Tuition at Large Private Colleges

Does not include room, other costs. Adjusted for inflation.

College	1981	1991	Percent Change
Harvard University	$11,530	$17,152	49%
Princeton University	$10,863	$16,570	53%
Yale University	$10,713	$16,300	52%
Washington University	$9,434	$16,110	71%
University of Pennsylvania	$10,339	$15,894	54%
Mass. Inst. of Technology	$9,290	$15,600	68%
Columbia University	$10,039	$15,520	55%
Stanford University	$10,698	$15,102	41%
Emory University	$8,166	$14,780	81%
Rice University	$5,536	$8,018	45%

SOURCE: Universities

Top 10 Private College Endowments

Adjusted for inflation.

Rank	College	1981	1991	Percent Change
1	Harvard University	$2,557,197,690	$4,669,683,000	82%
2	Princeton University	$1,379,863,327	$2,624,082,000	90%
3	Yale University	$1,187,592,079	$2,566,680,000	116%
4	Stanford University	$897,496,568	$2,043,000,000	128%
5	Columbia University	$884,625,743	$1,525,904,000	72%
6	Washington University	$399,428,601	$1,442,516,000	261%
7	Mass. Inst. of Technology	$749,530,026	$1,442,526,000	92%
8	Emory University	$378,871,241	$1,289,630,000	240%
9	Rice University	$556,675,611	$1,140,044,000	102%
10	University of Chicago	$594,994,719	$1,080,462,000	82%

SOURCE: National Assoc. of College & University Business Officers

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for the University of Pennsylvania's veterinary school, Penn officials howled.

Without that money, they warned, the 109-year-old school — the only veterinary school in Pennsylvania — would have to shut down. Each year, they said in a blitz of publicity, the school graduates about 110 veterinarians and treats 50,000 animals. It is one of only 27 such schools left in the nation, they said.

What was not said is that $15.3 million is a drop in the bucket for this educational giant — the third-largest private school in the nation when ranked by total revenues.

Or that Penn could make up the lost state aid with just *four days* of its $1.3 billion a year revenues. If Penn had to cover the vet school's lost state subsidy, it would take a 10 percent bite out of the school's yearly profits.

Penn is both Philadelphia's largest private employer — 16,645 — and its largest nonprofit property owner. It is not unique, though, among tax-exempt universities.

The 10 largest private universities and their revenues, including their hospitals, in fiscal year 1990, according to the U.S. Education Department, were: Stanford University, $1.4 billion; California Institute of Technology, $1.2 billion; University of Pennsylvania, $1.2 billion; Johns Hopkins University, $1.1 billion; New York University, $1.1 billion; MIT, $1.1 billion; Harvard University, $1 billion; University of Chicago, $927 million; Duke University, $911 million; and Columbia University, $841 million.

In 1991, Penn's total revenues of $1.3 billion from the university and its hospital were greater than the sales of the Strawbridge & Clothier or Pep Boys chains. If Penn were a publicly traded company, it would be one of the 20 largest businesses in the region.

As for the vet school, Penn provides only $1.7 million of its own money each year for the school's $36 million annual budget.

Part of that comes from fees animal owners

Continued on next page

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Continued from preceding page

pay to have their pets and livestock treated at the school — about $9 million a year.

Students from Pennsylvania pay $16,326 a year to attend; and the state has provided a subsidy of $15.3 million a year. Last year, the vet school's unreimbursed care for animals — charity, in essence — totaled about $300,000, or less than 1 percent of the school's operating budget.

It is still uncertain whether the state will continue to fund the vet school. Penn admitted a new veterinary school class last fall and plans to keep the school open to graduate the class but would eventually close it if state money is eliminated, said John W. Gould, Penn's acting executive vice president.

"It's not something we want to do, but we would be compelled to if we didn't get that support," he said.

Gould said Penn also would stop accepting new welfare patients at its dental clinic in West Philadelphia if the state carries out a threat to eliminate $1.5 million in annual funding.

Penn's tax-exempt mission isn't to extend charity care to dental patients in West Philadelphia, Gould said: "We are tax-exempt because we educate people and we do research."

■

Nurtured in part by tax breaks, by the economic boom during much of the 1980s and by contributions, many private colleges and universities have undergone phenomenal growth in the last decade. Their endowment funds — in essence, their savings accounts — have grown fat.

The growth is continuing into the '90s.

A survey of public and private schools by the National Association of College and University Business Officers found that among the 395 schools that responded, total endowment was $65 billion in 1991.

Endowment value of the 10 largest private schools added together was $19.8 billion, triple the total a decade before. Harvard led the list with $4.7 billion.

Among the 286 private schools in the survey, the average endowment per student was $47,392. Princeton had the highest endowment value per student — $413,306, or nearly nine times the average.

Between 1981 and 1991, Princeton's endowment increased each year an average 11 percent. Over that period, undergraduate tuition increased nearly 9 percent a year.

The University of Pennsylvania's endowment was $826 million in 1991. Although it wasn't as large as Harvard's, Penn's revenues were on a par. Penn's revenues of $1.34 billion compared with Harvard's $1.02 billion.

Of the $65 billion in total endowments in the survey, about 89 percent was invested in common stock and other securities, with the balance in venture capital, leveraged buyouts, oil and gas and real estate.

Endowment funds of tax-exempt, nonprofit educational institutions are so large that they have spawned other tax-exempt, nonprofit corporations to manage all that money.

Harvard has its Harvard Management Co., whose top employees are paid Wall Street-size salaries.

And one of the largest nonprofit corporations in the nation — the Common Fund in Fairfield, Conn. — was established by a Ford Foundation grant in 1971 to pool the endowments and other investments of more than 1,000 educational institutions. The goal is to maximize the return of each school.

In 1991, the Common Fund managed $11.6 billion in assets.

Most larger colleges in the Philadelphia area participate in the Common Fund, including Temple University, Swarthmore College, Villanova University, La Salle University, Haverford College and St. Joseph's University.

In 1991, the fund collected $282 million in interest on savings, $319 million in dividends and $270 million in gains from the sale of securities. Revenues totaled $909 million.

Only $158,066 was declared as taxable.

■

Rebutting criticism of high tuitions, Harvard's Rudenstine and other educators point out that in the 1980s, scholarships funded with university money increased from $1.6 billion to $5.4 billion.

Financial aid *has* increased. But with tuition rising at 9 percent a year in some cases, students still are losing ground.

The Inquirer analyzed data collected by the U.S. Department of Education from 1,600 schools that listed how much scholarship money they gave in the 1989-90 school year from their own funds — not government or private scholarship and loan money funneled through the schools.

On average, private colleges and universities gave away the equivalent of 7 percent of their revenues — not including university hospital revenues — as scholarships.

MIT gave away 2 percent.

Ivy League schools that were part of the information-sharing group with MIT ranged from 4 percent at Columbia to 8 at Brown.

Penn gave 6 percent.

California Institute of Technology — the largest private school when university hospital revenue is not counted — gave less than 1 percent in student aid.

Johns Hopkins University gave 3 percent.

Stanford University gave 4.

Although the big universities contributed relatively little, some schools — particularly smaller ones — were especially generous.

One standout was the College of the Ozarks in Missouri, which devoted one-third of its yearly revenue to scholarship aid. In its annual rating of colleges, U.S. News & World Report has ranked it as one of the best liberal arts colleges in the Midwest. What makes this college different from most, though, is that students attend for free.

"Lack of funds should not keep students from attending college," the College of the Ozarks' catalog says. "The college will provide a way to meet the cost of education for every deserving student."

Nine out of 10 students entering each class would have a difficult time financing a college education. The 1,500 students get a "free ride" by working 15 hours a week on campus and 40 hours a week in summer.

When they graduate, students may apply to their alma mater for scholarships to the graduate school of their choice. It can't be College of the Ozarks, which offers only undergraduate degrees. Two of the 10 scholarships provide a free education through graduate school, which can include a professional school, such as law school.

■

"Confused about the economy?" the advertisement in the Wall Street Journal asked.

For $295, busy executives could buy a half-hour video and watch the economist discuss everything from long-term interest rates to an analysis of federal economic policy.

The tape was sophisticated — with animated fever charts showing the paths of indicators, a relaxed discussion of economic events over coffee a la *Wall Street Week* and "Macrovision" protection to prevent copying.

What made this product different is its source. This video didn't come from one of the many economic consulting firms that make their living giving advice.

This video was produced, marketed and distributed by the tax-exempt Wharton School of the University of Pennsylvania — one of four produced each year starring Wharton finance professor Jeremy J. Siegel.

For Wharton and other schools, doing business outside the classroom has grown as the college-age population has shrunk.

As these tax-exempt schools have turned to broader definitions of "education," they've moved further into the marketplace, where they compete with tax-paying companies.

Wharton, for example, runs 120 seminars for 4,700 executives a year. Penn State sponsors executive development programs at its State College campus; they last from two to four weeks and cost $1,900 per person.

Temple University is expanding its outside ventures. It offers courses in how to use computer software programs ("Profits and Losses: Creating a Budget Spreadsheet with LOTUS") for upward of $475 for a two-day seminar; how to use direct mail marketing for $275; how to improve customer service for $225 and how to write a better business letter for $225.

Some schools have taken their seminar business on the road. California State University/Los Angeles has conducted seminars in 14 states, lecturing on federal and state employment regulations. The cost: $595 per person.

In many cases, brochures advertising these services are mailed using a nonprofit organization mailing permit. Nonprofits in 1991 paid an average of 65 percent of what other organizations paid to send out second- and third-class mail — 14 billion pieces a year.

Taxpayers make up the difference.

Nonprofit universities have invested millions of dollars in commercial businesses. Precisely how much is not known because the government doesn't require that it be disclosed. Some schools don't like to talk about that side of the education business.

For example, the University of Pennsylvania owns interests in several businesses that aren't tax-exempt, including the Penn Tower Hotel. Other taxable ventures include University City Associates Inc., a property rental company; Walnut West Associates, commercial real estate; Cabaret Company, a New York theatrical production firm, and Genesis Ltd., a Bermuda-based insurance company.

When The Inquirer asked for details on the businesses, the Penn Office of University Relations responded:

"Your most recent request for additional information relates to the university's for-profit subsidiaries. As these records are not subject to inspection, we are respectfully declining this request."

Penn's commercial ventures were valued at $64 million and had income of nearly $18 million in 1991, according to its IRS filing. The university would not disclose how much, if any, federal income tax it paid on its taxable subsidiaries.

Penn's interest in for-profit companies pales compared with some schools. Boston

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University has invested heavily in commercial enterprises, including a biotechnology firm, Seragen Inc.

Seragen got its start in 1979 as a joint venture between Boston University and several faculty members. The scientists wanted to develop and market monoclonal antibodies designed to fight specific diseases — then and now a promising technology. For financing, they turned to the university.

In 1987, Boston University invested $26 million in Seragen, gaining a controlling interest. Since then, the university has provided most of the working capital. When Seragen went public last year, the university canceled a $66.5 million loan to Seragen in return for additional common stock.

Following another stock offering last month, Boston University controlled 60 percent of Seragen's stock — an investment worth about $75 million at current prices.

The prospectus for the initial stock offering warns of the risky nature of the business. "Products currently at the most advanced stages of development will not be available for commercial sale or use for several years, if at all," the company said in its Securities and Exchange Commission filing.

As of the end of 1992, Seragen had accumulated losses of $91 million. "There can be no assurance that the company will ever achieve a profitable level of operations," the filing said.

Nevertheless, Boston University continues to bet a sizable chunk of its $337 million in investments on Seragen.

Seragen board members include many executives and trustees of the university. Chairman James M. Howell, former chief economist of the Bank of Boston, is on the university board of trustees. Seragen pays Howell $50,000 for 50 days of consulting a year, according to the SEC documents.

Another Seragen board member, John R. Murphy, is a BU medical professor and chief of biomolecular medicine at the university hospital. According to SEC documents, Murphy is paid $71,000 a year for consulting on "biotechnology matters."

And what has happened over the last decade at Boston University's other activity — providing an education?

Tuition has tripled since 1980, rising to $16,590 this year. Today BU's tuition is nearly as high as Harvard's.

A year ago, the U.S. House Select Committee on Children, Youth and Families set out to answer the question, "Why do college costs keep going up every single year?"

"The focus in higher education today is on research, not teaching," the committee concluded in a 1992 report. The study cited data from the nation's public universities, but noted that many of the same problems may be found at private schools.

Among the committee's findings:

• Labor costs have soared, in part because professors spend less time in the classroom. Faculty members used to teach 15 credit hours a semester (about five courses). The load over time was reduced to 12 credits, then nine credits and "in many places it is six credits or lower" today. Colleges have had to hire additional teachers and teaching assistants to cover classes.

• Research has cut into teaching time. "A number of faculty avoid teaching altogether by buying out their teaching time with the proceeds from research grants or outside consulting."

• The school year now averages 30 weeks, and every seventh year many professors get a year off for sabbatical at full or partial pay. The average salary for a professor at a public university is about $63,000.

• Large undergraduate lecture classes are common. A marketing class at the University of Colorado had 618 students; a basic political science class at the University of Illinois/Urbana had 1,156 students.

• Administrative costs have increased sharply. In 1950, public colleges spent 27 cents on administration for every dollar spent on instruction. In 1988, they spent 45 cents for administration.

After the committee report was issued, the National Association of Independent Colleges and Universities dismissed it as "incredibly simplistic," said Timothy J. Morrison, the committee's chief investigator.

Morrison said recently that he had received more than 150 letters and dozens of calls after the report was released — most supporting its findings.

"It's a profession that has not been criticized very much," Morrison said. But "it's an industry. I don't care how you slice it."

■ **Tomorrow:** The IRS polices nonprofits. It has one agent for every 2,424 exempt organizations.

Colleges score with tax-free income from big-time sports

By Gilbert M. Gaul
and Neill A. Borowski
Inquirer Staff Writers

The University of Notre Dame collects about $1 million a game from NBC to broadcast its home football games.

The National Collegiate Athletic Association gets $70 million from CBS Sports for television rights to the school's basketball championship tournament.

The College Football Association negotiated a $16 million package for its members with ABC in 1990.

All this commercial revenue is off the tax rolls. The colleges don't pay a penny in taxes on it.

To most Americans, it's no secret that big-time college sports are big business. But the IRS doesn't see it that way.

As a result, you're helping subsidize these lucrative games in several ways.

College sports programs are conducted under a broad grant of tax-exemption intended to encourage educational activities. Congress and IRS ruled that college athletic events are entertainment, not educational activities.

As a result, hundreds of millions of dollars of income from television broadcasts, advertising, royalties, licensing fees and ticket sales are swept off the tax books each year. And into the universities' till.

Take Notre Dame. In 1990, university officials signed an unprecedented agreement with NBC to broadcast its six home football games. The five-year deal was reported to be worth $35 million, or about $12 million a game.

"All revenue from athletic contests is considered related to the school's exempt purpose. As an educational 501(c)(3) corporation, it's considered related. We don't pay taxes," an attorney for Notre Dame said.

Perennial football powers such as Penn State, Michigan, Miami and Florida State routinely pick up millions of dollars from football broadcasts. Income from year-end bowl games, also tax-exempt, adds $50 million more to these schools.

Critics say it would be one thing if the profits from these events were used to lower tuition or pay teachers' salaries or were used for some other truly educational activity. But by and large, they are not.

Instead, the money is used to subsidize other sports. Some of it goes to pay big salaries and bonuses for coaches.

The Knight Commission, a 22-member panel that spent a year examining the state of college sports, described it this way in a March 1991 report:

"Within the last decade, big-time athletic programs have taken on all of the trappings of a major entertainment enterprise, with many high-profile football and basketball programs now out of control commercially and dangerously close to professionalism."

Universities defend the businesslike approach, saying they often break even due to the television money," says Richard L. Kaplan, University of Illinois law professor and tax specialist.

A decade ago in the Columbia Law Review, Kaplan wrote that college sports at big universities are essentially a trade or a business. The commercial activities of other nonprofit organizations are subject to federal taxes, but not commercial sports activities of colleges.

"College sports have become a major money-making venture ... with educational values largely peripheral to the activities," Kaplan wrote. "This has resulted in a double standard. Other nonprofits pay taxes on commercial ventures, while intercollegiate sports are exempt."

Critics have attacked the nonprofits' tax-exempt status for years, but the contention that how they made money didn't matter, only how they spent it. A tax on the income from commercial ventures of tax-exempt organizations was enacted. It is called the Unrelated Business Income Tax.

But an Inquirer review of 40 years of legislative history shows Congress has never studied whether income from television contracts licensing agreements or royalties should be taxed.

Absent guidance, the IRS has taken the position that income universities earn from athletic events is protected by the schools' broad grant of exemption as educational and charitable organizations.

One of the chief beneficiaries of the IRS ruling has been the NCAA, which describes its tax-exempt mission as governing and policing college sports. In 1990, its revenue was nearly $188 million, mostly from television broadcast rights. IRS returns show.

As the NCAA has grown, it has become more entrepreneurial. Today, it owns a separate marketing corporation, real estate holding company and foundation. The nonprofit, based in Overland Park, Kan., receives millions each year in royalties and licensing fees from patents on its logos. One of its most profitable markets is sports.

Most of the NCAA's money is spent on promoting sports — marketing, entertainment, collecting statistics, producing videos and highlight films, and lobbying legislators.

The Enforcement Department accounts for just 2 percent of its budget. The NCAA has 14 investigators to cover 1,000 schools — or one investigator for each 71 schools.

Sometimes schools use profits to subsidize non-sports activities. For example, at the University of Louisville, a separate, tax-exempt sports foundation has contributed $9 million to the university for general use in recent years, according to spokeswoman Denise Fitzpatrick.

Congress rewrote the tax code more than 40 years ago to address the commercial issue. Legislators were concerned that nonprofits were taking advantage of their special status to operate profit-making firms and to avoid paying taxes.

Congress rejected the nonprofits' contention that how they made money didn't matter, only how they spent it. A tax on the income from commercial ventures of tax-exempt organizations was enacted. It is called the Unrelated Business Income Tax.

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How Much Universities Spend on Scholarships

Percentage of the school's revenue in fiscal 1990.

The Philadelphia Inquirer

City Edition Wednesday, April 21, 1993 35 Cents

Warehouses of Wealth: The Tax-Free Economy

Fourth in a series.

The IRS doesn't have the staff or money to adequately police nonprofit businesses. An audit of them all would take years. So they operate unfettered.

The IRS, an enforcer that can't keep up

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS
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In September 1987, a congressional committee investigating television evangelists asked Pat Robertson to testify about his Christian Broadcasting Network, which produces the *700 Club*.

Robertson, on the verge of entering the 1988 presidential race, told the panel he was too busy to appear. Instead, his son, Timothy, sent a letter that described the Virginia Beach nonprofit this way:

"The mission of CBN is to prepare the United States of America and other selected nations of the world for the coming of Jesus Christ and the establishment of the Kingdom of God on Earth. CBN's ultimate goal is to achieve a time in history when the 'knowledge of the Lord will cover the Earth as the waters cover the sea.'"

CBN had another goal: building a profitable cable television network, The Family Channel.

Formed in 1977 by CBN, The Family Channel had grown steadily through the 1980s, attracting millions of dollars in advertising. By 1988, its revenues dwarfed those from the network's religious broadcasts. For every $1 generated by religious programs, The Family Channel's nonreligious programming brought in $4.50 — more than $41 million.

Inside CBN, executives were concerned that the Internal Revenue Service might crack down on the tax-exempt charity for becoming too commercial.

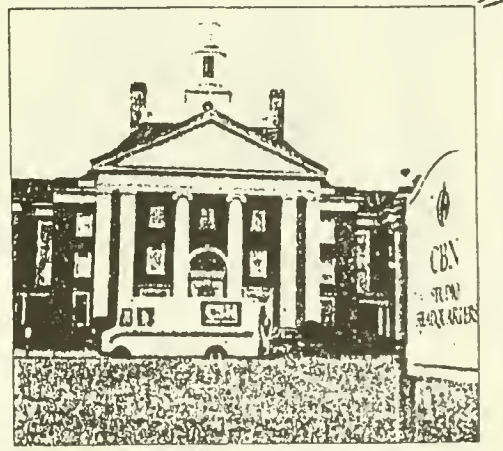
They needn't have worried.

Drowning in its own thicket of rules and regulations, understaffed and unprepared to audit large, diversified nonprofits, the much-feared federal service turned out to be no threat; it made no move to challenge Christian Broadcasting Network, let alone to revoke its tax exemption.

Nevertheless, CBN officials decided to act.

In November 1989, Pat and Tim Robertson formed International Family Entertainment Inc., a for-profit company, and put together a deal to buy The Family Channel from CBN for $250 million.

See IRS on A10



The Philadelphia Inquirer / MICHAEL MALLY

When Christian Broadcasting Network's Family Channel became a commercial success, executives feared IRS scrutiny. They needn't have worried.

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As nonprofits grow, IRS is outnumbered

IRS from A1

They put up $150,000

In 1992, the new company went public. Within hours, investors gobbled up 10 million shares at $15 a share.

Overnight, the Robertsons' modest $150,000 investment became a personal fortune of $90 million.

It could have been a venture capitalist's dream come true — only in this case the cable channel was nurtured under the protective umbrella of a tax-exempt, nonprofit organization, underwritten for a decade by taxpayers.

Not that taxpayers had any idea they were helping the Robertsons build a television empire. Few understand that they subsidize the nation's $850 billion nonprofit economy through their taxes. In 1992, those tax breaks to nonprofit groups were worth more than $36 billion by Inquirer estimates.

The Internal Revenue Service is charged with supervising this nonprofit economy. But an 18-month Inquirer examination of tax-exempt organizations has found that the IRS doesn't have the staff, money or technical resources to adequately police the ever-growing number of exempt groups.

IRS's Exempt Organizations Technical Division, which is responsible for approving new exempt organizations and policing existing ones, in 1991 had 486 employees to watch over an estimated 1.1 million organizations — or one worker for 2,279 exempt groups.

And that gap is widening.

Between 1980 and 1992, the IRS approved 353,567 new nonprofits — an average of 29,000 a year.

While those numbers were growing, the staff of the Exempt Organizations section was declining: from 509 to 495 employees.

In 1992, the number of nonprofit organizations had grown to an estimated 1.2 million. That raises the ratio to one IRS employee for every 2,424 organizations.

Nor has the IRS's budget for policing nonprofits kept up.

In 1980, the agency spent $27.6 million to oversee exempt groups, or an average of $32.61 per organization.

In 1992, IRS spent $35.7 million, an average of $29.75 per organization.

Taking inflation into account, that meant IRS spending to supervise nonprofits declined by nearly 25 percent.

"There's always a budget limitation. That is part of life in any organization. Our challenge is to learn how to live with them and work with them," Howard M. Schoenfeld, a special assistant to the IRS commissioner, said in an interview.

Even when Congress asked if the agency needed more money to monitor exempt organizations, Reagan-era agency administrators in the 1980s turned it down. They testified before congressional committees that they had "adequate resources" to get the job done.

An array of data suggests otherwise. The number of audits of exempt groups declined sharply in the 1980s.

In 1980, the last year of the Carter administration, the IRS examined 23,807 tax-exempt organizations.

In 1988, the last year of the Reagan administration, it examined 11,907 nonprofits — a 50 percent drop.

Under George Bush, the number of audits inched back up to 14,891 by 1991.

Even so, with the rapid growth in new exempt groups, the IRS audited fewer nonprofits on a per-capita basis than a decade earlier. In 1980, it examined one of every 36 nonprofit tax returns. In 1991, it examined one of every 74 returns.

Today, the agency examines about 1 percent of the roughly 450,000 nonprofits that file an annual tax form, known as a Form 990, with IRS.

Even that figure is misleading.

There are another 750,000 or so nonprofits that do not have to file forms with IRS — exempt groups with annual incomes of $25,000 or less.

The IRS counts each tax return that an agent examines as a separate audit — even if it involves the same organization. That practice inflates the overall count, because an agent who reviews three years of one nonprofit's tax return counts that as three audits.

This makes it seem as if the IRS is monitoring more nonprofits than it actually is.

In 1991, the IRS reported it had audited the returns of nearly 15,000 exempt organizations. It turned out that after adjusting for double-counting, the IRS really had examined the returns of 6,011 exempt groups.

The audit is the principal tool the IRS has to ensure that groups aren't taking advantage of their tax-exempt privilege.

The decline in audits indicates that the IRS has been unable to keep up with the growing commercialism of the nonprofit sector.

In the last decade, large nonprofits have invested billions of dollars in for-profit ventures, federal data and an Inquirer examination of 6,000 tax returns shows.

The IRS must rely on these tax-exempt organizations to report, on a special form called a 990-T, that they have taxable income — that is, income from businesses not related to their tax-exempt purpose.

Interviews and records indicate that many large nonprofits fail to comply, or underestimate their tax liability.

"A fairly healthy percentage of exempt organizations who ought to be filing 990-Ts don't," said Marcus S. Owens, director of the Exempt Organizations Technical Division.

"A surprising number only filed after an audit has started. Of those who grudgingly admit they have some tax liability, we have found that 40 percent are going to underestimate their taxes."

Congress and others have begun to question the quality of the IRS's audits of large nonprofit organizations, such as hospitals and universities.

In 1991, IRS and Treasury Department administrators acknowledged that the agency had been slow to develop sophisticated audit techniques.

"Frankly, I think it took the IRS time to develop an audit program that was appropriate to the modern hospital," Michael J. Graetz, deputy assistant Treasury secretary for tax policy, testified at a congressional hearing.

In most cases, audits consisted of little more than a cursory review of a hospital's Form 990, another official said.

"The depth of those audits has been pretty much confined to what is within the four corners of the information return that is filed by the hospital," assistant IRS commissioner John E. Burke testified in July 1991.

"We look at the hospital, we look at the operations of the hospital, and we have not gone into the transactions and the ventures and the subsidiaries that are controlled by the hospital so that we can offer a complete picture as a result of our examination as to what the hospital is doing," Burke said.

A lawyer for a large Philadelphia hospital characterized the audits more bluntly.

"The field audits are totally worthless. The field agents don't know what they are doing. They only look at one entity. They don't track the money into the subsidiaries. There are a lot of awfully bright people in the IRS, but they seem to be stumbling."

The lawyer added, "There's no way I or anyone else will tell you this on the record, for obvious reasons."

Owens does not dispute such characterizations. "When we did focus on large exempt organizations, we didn't have the resources and systems in place," he said. "We were missing things . . . and we were having many problems."

The IRS announced recently that it was stepping up the intensity of its audits of large hospitals and universities. Instead of a single agent going out to examine the books, the agency said it would send a team of attorneys, accountants, computer experts and other tax specialists.

"The idea is to put in place all of the concepts we use in our audits of the largest for-profit corporations," said Schoenfeld, special assistant to the IRS commissioner.

There is a catch.

Because the new "comprehensive evaluations" are more time-consuming, the IRS expects to conduct only a dozen or so a year.

And the number of overall examinations of nonprofits is expected to decline further.

In March, Owens said 23 comprehensive hospital audits were underway. Some could take two to three years to complete.

There are about 3,200 nonprofit hospitals in America.

Even if IRS could complete examinations of 23 in a single year, auditing all the nonprofit hospitals would take 139 years.

■

Congress, which periodically finds fault with the way IRS does its job, hasn't made the agency's job any easier.

Over the years, Congress has greatly expanded the definition of charity and has moved to block enforcement action against selected nonprofits engaged in commercial activities.

Since the 1950s, nonprofits have been required to pay taxes on income-producing activities that are unrelated to their tax-exempt purpose.

Philadelphia Inquirer April 21, 1993 p. A10

From Nonprofit to Big Profit

NONPROFIT ERA

1977 through 1989

1977

- CBN Satellite Network, later renamed The Family Channel, formed by Pat Robertson's Christian Broadcasting Network.
- Religious programming.

1981

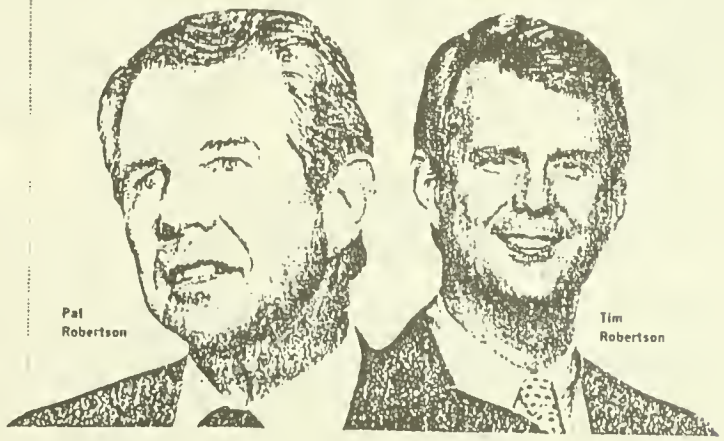
- Becomes advertiser-supported, entertainment-oriented cable network.
- Moves away from religious programming toward "family-value" programs.

1988

- CBN/Family Channel broad casting revenue. $50.6 million (Exempt revenues: $9.2 million) (Other revenues $41.4 million)
- Concern about IRS scrutiny over growing commercialism.

1989

- Family Channel appraised in anticipation of sale.
- Broadcasting revenue: $62.8 million. (Exempt revenues: $7.7 million) (Other revenues: $55.1 million)
- Pat and Tim Robertson form private, for-profit company, International Family Entertainment Inc. (IFE), to buy The Family Channel from CBN.
- Pat invests $100,000; Tim, $50,000.
- Tele-Communications Inc. invests $22 million.



Pat Robertson

Tim Robertson

FOR PROFIT/PRIVATE

1990 through 1991

1990

- Robertsons' IFE buys The Family Channel from CBN for $250 million in notes convertible to IFE shares.
- Nonprofit CBN pays no taxes on sale.
- IFE/Family Channel revenue: $93 million.
- IFE/Family Channel profits: $14 million

1991

- IFE/Family Channel revenue $114 million.
- IFE/Family Channel profits $20 million
- Salaries:
  Pat Robertson, chairman, $364,984
  Tim Robertson, chief executive, $490,204.
- Pat Robertson remains chairman of CBN (nonprofit), collects no salary

FOR PROFIT/PUBLIC

1992 to present

1992

- Public stock offering (April) IFE/Family Channel 10 million shares at $15/share: $150 million.
- Robertsons retain control of IFE with 69 percent of voting stock.
- Their $150,000 investment becomes worth $90 million.
- 1992 salary, bonuses
  Pat Robertson, chairman, $390,611.
  Tim Robertson, chief executive $465,731
- Pat Robertson remains chairman of CBN (nonprofit)

1993

- Family Channel plans to go international with versions in Great Britain and Korea

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Congress, which periodically finds fault with the way IRS does its job hasn't made the agency's job any easier

Over the years Congress has greatly expanded the definition of charity and has moved to block enforcement action against selected nonprofits engaged in commercial activities.

Since the 1950s, nonprofits have been required to pay taxes on income-producing activities that are unrelated to their tax-exempt purpose

It's up to the IRS to determine what unrelated activities are and who must pay these taxes

But on half a dozen occasions, special legislation has been used to overrule the IRS when it did direct specific tax-exempt organizations to pay taxes

Congress has ruled that income earned by nonprofits from buying and selling their mailing lists is not taxable.

Congress has ruled that income nonprofits get from operating certain commercial television stations is not taxable.

Congress has ruled that income nonprofits get from certain horse racing and parimutuel betting is not taxable.

Congress has ruled that income nonprofits get from some trade shows is not taxable.

Congress has ruled that income nonprofits get from bingo games is not taxable.

Congress has ruled that income nonprofits get from operating an orange grove is not taxable.

In each case, the decision was made on an ad hoc basis, frustrating efforts of the IRS to establish a clear policy on commercial activities of nonprofits.

Former IRS Commissioner Lawrence Gibbs put it this way during 1987 testimony:

"While I have no quarrel with the right of Congress to exempt certain income from tax, I would hope that in the future an attempt could be made to define unrelated business income in a way that would avoid the impression of a piecemeal repeal of the unrelated business income tax."

It was Congress, too, that complicated IRS enforcement by substantially expanding the definition of charity.

Today, groups may qualify for exemption from taxes under any of 25 separate classifications. They range from civic leagues to farmers' cooperatives.

IRS examiners have little choice but to approve requests for exemption.

This results in any number of interesting decisions.

In recent rulings, IRS examiners agreed to exempt an association of Chinese software traders in California, a real estate investment firm owned by Harvard University, a group of Florida atheists, an association of Indian travel agents, and the Zoroastrain Society of Washington State.

And then there is the Council for National Policy, a conservative think-tank.

Following the election of Ronald Reagan in 1980, the council moved from Texas to Washington. It was granted tax-exempt status on Nov. 9, 1981, as a charitable, educational organization. Contributions to the council became tax-deductible.

The council's primary activity consisted of holding several meetings a year for members and selected speakers, at posh resorts around the country. The sessions were not open to the public.

Nor were the remarks of the speakers generally published. Membership was by invitation only and often limited to high-powered politicians, executives and members of the media. Membership fees ranged from $100 for associate members to $5,000 for members of the board of governors.

In 1990, the council's executive committee consisted of Reed Larson, president of the National Right to Work Committee; retired Lt. Col. Oliver L. North, the former White House aide; Howard Phillips, chairman of the Conservative Caucus, and Paul Weyrich, president of the Free Congress Foundation.

In 1990, the IRS questioned the exclusionary nature of the council. Two years later, the IRS revoked the group's tax-exempt status, saying it represented the private interests of its members and did not serve a public, charitable purpose.

The council appealed and the case landed in U.S. Tax Court, which hears tax disputes.

Following a flurry of initial filings, attorneys for both sides agreed to a 90-day delay. Lawyers for the council had filed a new application for tax-exempt status and the IRS agreed not to press ahead with the lawsuit until its hearings officers could rule on the new application.

"We decided that it was easier to make a revised application than to go through the expense of the court case," said Morton C. Blackwell, a former Reagan White House aide who took over as executive director of the council in 1991.

Asked the group's purpose, Blackwell said: "We discuss public policy questions and bring in excellent speakers to share their information, and that information is used by our members and others in determinations about public policy questions."

"The IRS had said everything we were doing was legitimate. It was a question of whether we were serving a public purpose," Blackwell said.

The council's solution was to start publishing a semiannual journal of some speeches made at its closed sessions. The first issue of Policy Counsel appeared in the spring of 1992, with six essays by such conservatives as newspaper columnist Cal Thomas and economist Milton Friedman.

IRS reconsidered the exemption. It determined that by publishing the journal twice a year, the council met its criteria for a public educational charity. On Aug. 4, 1992, the IRS restored the exemption, retroactive to Jan. 30.

Membership could still be limited to a select, powerful few. Its quarterly meetings could still be closed to the public. And the majority of its activities could still benefit only its members.

Speaking generally, Owens said that the IRS makes its rulings on a "case-by-case" basis. The more public an organization is, the more likely its activities may be viewed as educational, and qualify for exemption.

However, sometimes a lawsuit or threat of a lawsuit may sway a decision, Owens said. "It's the hazard of litigation. You don't want to have a losing case on the record."

Congress' generosity in defining who qualifies as tax-exempt has resulted in IRS approval of nearly 354,000 groups in the last 12 years.

Having created this huge shadow economy, Congress has paid scant attention to the consequences.

It has not conducted a major examination of the growth of nonprofit groups or their effect on the federal Treasury in a quarter-century. While Congress has held public hearings from time to time, the hearings' scope has been limited.

Even when Congress has addressed the subject, its actions sometimes have resulted in a windfall for nonprofits.

In 1976, Congress changed the law that said foundations could remain tax-exempt only if they gave away, each year, 6 percent of their assets. The change? Congress lowered the requirement to 5 percent.

As a result, between 1977 and 1991 an estimated 40,000 foundations were able to retain, rather than distribute in charity, more than $15 billion. In 1991 alone, the provision saved foundations about $1.5 billion.

Congress dabbled again in 1978. It took a hard look at the fact that foundations were required to pay a 4 percent excise tax on

Continued on next page

Continued from preceding page

their net investment income. Congress cut the tax to 2 percent.

In 1985, Congress revisited the excise tax issue. And decided that so long as foundations met certain other requirements, they should pay no more than 1 percent.

Congress has not always been so accommodating.

On several occasions, IRS officials asked for authority to levy fines or penalties against nonprofits found in violation of the rules. Under existing law, IRS has only two choices in such a situation: Revoke the organization's exemption or do nothing.

Fines or other intermediate sanctions, Owens and other IRS officials said, would give the agency more leverage in getting nonprofits to comply with the rules.

Congress has not heeded these requests.

■

Churches enjoy special tax-exempt status. They are not required to file an informational Form 990. And Congress has exempted churches and many of their related businesses from federal oversight.

The IRS cannot examine a church's financial records without undertaking complicated negotiations with the church. Even if a church agrees, the examination is restricted to a two-year period.

"The standards for getting in to see the books and records of churches are a fairly tall order," Owens said.

This has resulted in any number of problems. First, the IRS does not know how many churches exist. It estimates that the number is between 300,000 and 400,000. Needless to say, the IRS has no idea how much property or money is controlled by churches. Nor does it know how many churches operate travel tours, nursing homes, retirement villages or other commercial businesses.

Virtually any individual or group may declare itself a church, collect money and pay no taxes.

"Unlike nonreligious entities, churches are entitled to exempt status without any requirement of filing a request for exemption. They are automatically exempt," James J. McGovern, associate chief counsel of the IRS, told a lawyers group last April.

"When other entities file applications for exemption, these applications and related materials are open to the public. . . Because churches are excused from this general requirement, neither the IRS nor the general public knows who these organizations are or how many of them exist, let alone whether they are organized and operated under the rules of the tax code," McGovern said.

During the 1970s and '80s, this led to a number of problems involving televangelists, whose broadcast activities fell outside federal scrutiny because they were considered part of a church — and therefore not subject to filing requirements.

Another problem: Policing compliance by religious groups with the rule against involvement in political activity.

Churches are prohibited from engaging in political activities or election campaigns. But some have evaded that regulation by creating spinoff organizations.

After Pat Robertson failed to win the Republican nomination for President in 1988,

The Family Channel bounces signals off a satellite to transmit its programs. For 13 years, the channel grew under the umbrella of CBN, a nonprofit organization.

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Philadelphia Inquirer April 21, 1993 p. A11

he formed the Christian Coalition, a tax-exempt organization with more than 175,000 dues-paying members.

The IRS lists the coalition as an organization engaged in social-welfare activities, a category called 501(c)(4). Such organizations are not supposed to engage in partisan politics.

According to news reports in 1992, the coalition took part in campaigns to defeat liberal Democrats, provided extensive support for pro-family conservative and Republican candidates, sponsored political strategy sessions, distributed voter guides, and worked to elect 300 like-minded people as delegates to the Republican National Convention.

Last fall, a complaint was filed with the Federal Election Commission, contending that the tax-exempt Christian Coalition was "avowedly and predominantly" into partisan politics. The complaint came from the Rev. Jesse Jackson's organization, the Rainbow Coalition.

Christian Coalition officials fired back a letter charging Jackson's tax-exempt group with similar tactics favoring Democrats.

So far in the battle of tax-free coalitions, the IRS has taken no public action against either group.

Even when the IRS moves against churches for political activities, it sometimes takes years. In 1986, evangelist Jimmy Swaggart used his pulpit and the official magazine of Jimmy Swaggart Ministries to endorse Pat Robertson's presidential candidacy.

Nearly six years later, in 1992, the IRS announced that it had reached an agreement with Swaggart's group to change its corporate structure and not endorse political candidates. In the interim, Swaggart was forced to resign his ministries after a highly publicized sex scandal.

Given the difficulty the IRS has gaining access to church records, as well as various administrative appeals available to exempt groups, it's not surprising that it takes years to resolve such issues, Owens said.

■

The potential profitability of commercial enterprises owned by tax-exempt churches is documented in the growth of CBN.

In the early days, the Christian Broadcasting Network was just that: a network of television and radio stations that carried Robertson's religious programming.

Robertson — minister, television evangelist, entrepreneur, millionaire and presidential candidate — bought his first radio station in 1959. From that small entry into broadcasting, he used tax-deductible contributions from followers to build his program, The 700 Club, and his broadcasting empire.

In 1977, Robertson formed the CBN Satellite Network — shows transmitted by satellite to the burgeoning, and at that time program-hungry, cable television systems.

Four years later, in 1981, the network changed its name to the CBN Cable Network. The Family Entertainer. It became an advertiser-supported, entertainment-oriented cable network. The name was changed to the Family Channel in 1989.

Even as part of a nonprofit organization, the Family Channel was a fabulous money-maker, the crown jewel of CBN. During the last nine months that it was owned by CBN, the Family Channel's profits totaled $17.5 million.

Throughout those years, the Christian Broadcasting Network paid no federal taxes on its overall income. However, the network did declare the advertising revenues of the Family Channel as unrelated business income, subject to federal income tax.

It could not be determined how much was paid in taxes. Pat Robertson declined to be interviewed for this article.

In 1989 — the last full year during which CBN owned the Family Channel — about $55 million of the organization's $130 million in revenues came from broadcasting. Advertising revenue and cable fees were growing. The amount earned from broadcasting was nearing the amount sent in by contributors, almost $60 million.

Robertson's followers, who donated more than $600 million between 1985 and 1990, were entitled to tax deductions for their contributions, and CBN was shielded from income taxes.

In a way, Family Channel had become too much of a success.

By 1988, the channel was so commercially successful that CBN officials began to look into selling it, according to documents filed with the Securities and Exchange Commission.

The sale "arose out of CBN's concern that its status as a tax-exempt organization be preserved," says one of the documents filed by International Family Entertainment in connection with its stock offering last year.

The document says that "by the late 1980s, CBN's revenues from The Family Channel had increased, relative to CBN's income from contributions to its ministry, to a point where CBN's tax advisers recommended that The Family Channel's operations should no longer be conducted within CBN."

Pat Robertson's own fears were described, after the sale, in an interview with a cable-television trade publication.

> "No one has told us we have crossed that line, but in our opinion we are coming dangerously close," Robertson was quoted as saying in Broadcasting magazine. "The big problem we face is that whole statute is totally subjective."
>
> Subjective or not, the decision proved to be profitable for the Robertsons.

In the deal, Pat Robertson put up $100,000, his son, Tim, put up $50,000 and Tele-Communications Inc., the largest cable-television company in the nation, put up $22 million to form International Family Entertainment. The company, in turn, bought the Family Channel for $250 million.

In essence, CBN lent the buyer the $250 million to purchase the Family Channel, in the form of notes convertible into shares of stock in the Robertsons' International Family Entertainment.

Not only did Robertson find a financier in his tax-exempt organization, he also found a low-cost financier. The notes' interest rate is 4 percent in the first year, 4.75 percent in the second year and 6 percent in years after.

And interest only — none of the $250 million in principal — had to be paid in the first five years of the loan, according to CBN's 1991 tax return.

Even after the public sale of International Family Entertainment stock in 1992, the Robertsons retained control over the company.

Through shares he owns personally and shares he controls in trust for CBN, Pat Robertson controls 46 percent of the company.

His son, Tim, controls 23 percent with stock he owns.

Today, the Robertsons' total investment in International Family Entertainment has grown from the initial $150,000 to more than $90 million. Of that, Pat owns — both directly and through the trust — shares worth about $59 million. Tim owns shares worth about $32 million.

Of Pat Robertsons' shares, 77 percent is held in the Robertson Family Charitable Remainder Trust. Robertson retains voting and investment control, and thus beneficial ownership, of the shares. Any shares of the stock not sold before Jan. 22, 2025, will be transferred to Christian Broadcasting Network, according to an IFE proxy statement.

Pat Robertson remains as chairman of the Christian Broadcasting Network. In 1991, CBN's tax return listed no compensation for him and said he worked 40 hours a week at the nonprofit.

He also has an employment contract with Family Channel's parent company, International Family Entertainment, that lasts through Jan. 5, 1995, according to documents filed with the Securities and Exchange Commission.

As chairman of the public corporation, Pat Robertson in 1992 received $390,611 in salary and bonuses. Tim Robertson received $465,731.

Tim, president and chief executive of IFE, no longer is listed on the tax return as an officer at nonprofit CBN.

The Family Channel also has continued to flourish. It reaches more than 57 million American households — nine out of 10 households with cable and six out of 10 with television sets, the network says in its SEC filing.

And this year, The Family Channel plans to go global. It plans to establish a version in the United Kingdom and is joining with Hyundai Electronics Industries Co. to establish a Family Channel in Korea.

■

All 50 states have laws regulating nonprofits, but very few actually police their activities. Nor do they have much information about their effect on the economy.

States generally require nonprofits to file an annual report or tax return. State officials rarely audit nonprofit organizations or analyze their finances.

In most states, officials would be hard pressed to say how many tax-exempt groups even operate within their borders.

Jurisdiction often is divided among several agencies. One agency may be responsible for registering charities. Another may determine which nonprofits are eligible for exemption from sales tax. Still another may decide which groups don't have to pay state income taxes.

This helter-skelter approach can lead to policy conflicts. In Pennsylvania, nonprofits that no longer are tax-exempt in the eyes of the IRS are still treated as exempt by the state.

Pennsylvania has no equivalent of the federal Unrelated Business Income Tax, which is applied to the commercial activities of nonprofits — for instance, commercial advertising in magazines.

The reason is that Pennsylvania exempts nonprofits from paying any state corporate income taxes — period. The law makes no distinction between income from nonprofit activities and income from commercial activities.

In Pennsylvania, about 23,000 organizations also are exempt from state sales tax. New Jersey has more than 14,000.

How much revenue do the states forgo? It's anyone's guess. Officials from the two states say they don't know.

If they don't know, how do they police who's benefiting from these tax breaks?

Officials concede that their lists include nonprofits that are no longer in business and nonprofits that have lost their federal tax exemptions.

New Jersey officials denied an Inquirer request to review applications for sales-tax exemptions.

A four-inch printout of 833 pages of organizations exempted by New Jersey begins with the Absecun Baptist Church and ends with the Zoological & Ecological Research Fund of Poughkeepsie, N.Y. The list in Pennsylvania is public but costs $750, either on computer tape or in printout form, officials said.

Nonprofits also get discounted second- and third-class mail. Each year, about 14 billion pieces of nonprofit mail — mostly bulk fund-

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The Philadelphia Inquirer / MICHAEL MALLY

Health insurance costs Bill Hill and his wife, Ruth, a quarter of their annual income. "We can't take much more of these staggering increases," he says.

Taxed in some states, but not in others

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS

Independence Blue Cross and Pennsylvania Blue Shield are exempt from paying state and local taxes as nonprofit organizations whose charitable purpose is to provide low-cost insurance.

Low-cost?

Don't tell it to the Hills.

Bill and Ruth Hill are paying more than a quarter of their annual income for health insurance from Blue Cross and Blue Shield. Since 1981, the couple's premiums for their 65 Special Medicare policy have risen nearly 250 percent — from $906 to $3,145 a year.

"We can't take much more of these staggering increases. We don't have a retirement or pension. All we live on is our Social Security and a little savings," said 71-year-old Bill Hill, who lives in Northeast Philadelphia.

Thousands of other Blue Cross and Blue Shield subscribers have similar complaints. Many are abandoning the insurers. Since 1982, nearly 500,000 subscribers have quit because of rising premiums.

"It's no secret why these subscribers have left. It's expensive. We know that," said Blue Shield spokesman Doug Smith. Recently, the nonprofit insurers have taken several steps to hold down costs and make their insurance more affordable.

Some critics say it's too little, too late. To them, Blue Cross and Blue Shield look and act like any for-profit insurer.

"What I want to know is what does Blue Cross and Blue Shield do to justify not paying taxes?" asked Ann Torregrossa, an attorney for the Pennsylvania Health Law Project, an advocacy group in Chester. "Thousands of individual subscribers can't afford them any more. They've invested all kinds of money in for-profit businesses. Where's the charity?"

Congress asked the same question in 1986. It concluded that the health insurers — there were 80 plans nationwide at the time — no longer served a charitable purpose. Congress revoked their federal tax exemption and ordered them to start paying taxes in 1987.

Since then, more than half the states, including New Jersey, also have begun taxing the Blues.

Pennsylvania is an exception.

Its regulators continue to treat the four Blue Cross and one Blue Shield plans as nonprofit insurers.

The plans, whose revenues in 1991 were $7.8 billion, don't pay the state's 2 percent tax on insurance premiums. They don't pay state corporate income tax. They are exempted from sales tax. And in Philadelphia, Independence Blue Cross does not pay property taxes on its new $141 million office tower at 19th and Market Streets.

The value of these tax breaks for the five Pennsylvania plans totaled at least $160 million in 1991 — and more than $600 million since 1987, the year the federal government began taxing the Blues.

That $600 million would have been enough to provide doctor care and immunizations for all 320,000 children in Pennsylvania whose families had no health coverage — for four years.

Smith, the Blue Shield spokesman, said the Blues deserved their state and local tax breaks because, unlike some commercial insurers, they accept subscribers regardless of medical condition. The plans also subsidize the premiums of some subscribers, especially older people who buy their 65 Special Medicare policies, such as the Hills.

"That's got to be worth something, doesn't it?" Smith asked. "Think what would happen if we didn't subsidize those policies. The costs would be much higher."

The cost of these subsidies is borne by other Blue Cross and Blue Shield subscribers, who pay higher charges. In effect, those subscribers pay a hidden tax so the insurers can hold down charges for individual subscribers.

The Blues' tax-exempt status in Pennsylvania has saved them millions. If Independence Blue Cross had to pay real estate taxes on its new Philadelphia office tower, its bill from the city and school district would be $3.4 million a year.

The issue of whether the new building would be taxed went before the city's Board of Revision of Taxes in 1989. Lawyers for Blue Cross argued for exemption, saying the insurer had a "charitable purpose," and always had been exempt.

A representative from the city solicitor's office objected.

"Blue Cross' primary purpose is to provide health care coverage to those who can afford to pay for it," T. Braden Kiser, then chief assistant city solicitor, wrote in a 1989 memo. "Blue Cross 'gives' only to the extent that it receives something in return — a regular subscription payment."

The board granted the property tax exemption, despite the negative recommendation. The solicitor's office later filed suit to Common Pleas Court to challenge the exemption but did not pursue the case. A Blue Cross lawyer said recently that he thought the case was dead. David B. Glancey, chairman of the Board of Revision of Taxes, said he expected the case to be heard.

In 1991, Independence Blue Cross had revenues of $1.5 billion — larger than such well-known Philadelphia companies as Strawbridge & Clothier. Its cash reserves of $346 million would have ranked it, by itself, among the region's 50 largest firms.

Like other Blue Cross plans, Independence has invested heavily in for-profit subsidiaries. Between 1986 and 1991, it spent $29 million on acquisitions, which have lost an additional $18 million on operations. The biggest loser was Delaware Valley HMO. It has since been merged with another HMO and is now making a profit.

Collectively, Pennsylvania's Blue Cross and Blue Shield plans have invested more than $136 million in commercial spinoffs. They include health maintenance organizations, day-care centers, even a mail-order catalog.

As of 1991, the nonprofit insurers operated 56 separate subsidiaries, including 47 for-profit companies. By the end of that year, these ventures had lost $93 million, which subscribers' fees had to cover.

Like many big businesses, Pennsylvania's Blue Cross and Blue Shield plans have their own political action committees. In 1991, Blue PAC, financed by the Pennsylvania Blue Cross plans (and not Blue Shield), contributed $41,190 to politicians statewide. In the first five months of 1992, Blue PAC gave out another $16,495.

State Sen. Vincent J. Fumo, the Philadelphia Democrat, received $3,500 in contributions from Blue PAC. Fumo is a director of Independence Blue Cross.

Asked about the contributions, Independence Blue Cross said in a written statement:

"Senator Fumo does an outstanding job in Harrisburg for the Philadelphia community and is a leading member of the state Senate. He deserves and merits the support of his associates at Blue Cross."

Asked why the state decided not to follow Congress' decision to tax the Blues, Pennsylvania Insurance Commissioner Cynthia M. Maleski declined to comment.

All this has left the Blues in Pennsylvania in a strange position. As Blue Shield spokesman Doug Smith put it:

"We're a hybrid organization. That's a good word to describe us. We pay taxes at the federal level, but we're a nonprofit for state purposes."

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Legislators protect favorite nonprofits

Continued from preceding page

raising solicitations and publications — are handled at rates less than individuals or businesses pay. That list, too, is secret.

By act of Congress, the names and addresses of postal patrons aren't open to the public.

■

Efforts by IRS to police the conduct of nonprofits can run into ferocious — and successful — opposition.

Consider the Cotton Bowl.

In the summer of 1977, the IRS notified the Cotton Bowl Athletic Association that it planned to tax the revenues the association received for broadcasting the New Year's Day game in Dallas.

Reaction was fast and furious.

Although colleges and universities paid taxes on their purely commercial ventures, this was the first time the IRS had attempted to tax income from intercollegiate sports.

Bowl officials and universities banded together in protest. With the help of lawyers and several members of Congress, they persuaded the IRS to drop the proposal.

Fourteen years later, the issue resurfaced in a different form. In December 1991, the IRS published Technical Advice Memorandum 9147007, in which it argued that the substantial fees companies paid to sponsor bowl games and other events could be construed as purchasing advertising — and thus taxable.

The memorandum did not name the bowl games or corporate sponsors in question. But it later became public that the memo was directed at the Mobil Cotton Bowl and the John Hancock Bowl.

Mobil Oil Corp. and the John Hancock Mutual Life Insurance Co. had agreed to pay the bowls millions of dollars in fees. In return, the bowls agreed to use the corporate name and display the companies' logos prominently during the game and in promotions.

Again, the IRS decision to go after the Bowls set off a wave of public protest. The bowl groups, universities and corporate sponsors all argued that the publicity wasn't advertising; it was merely recognition of a donor's generosity. It was no different from public television recognizing Mobil Corp., or any other donor, for helping underwrite a program, they said.

This time, the IRS didn't go after the income from television broadcast rights. Instead, it went after the advertising.

In January 1992, the IRS issued proposed guidelines for its agents to use in examinations of such sponsorship arrangements. The guidelines required the agents to take a more aggressive view of the fees paid by sponsors and the benefits received in return.

The IRS was inundated with 339 written comments. Most were from organizations subject to the effort to tax sponsor payments, and almost all were negative. Sports groups were particularly incensed.

"The John Hancock Bowl has provided quality entertainment and an improved quality of life for El Pasoans for 58 years," the bowl organization's executive director, Cricket Musch, wrote. "The taxation of these corporate contributions would severely hamper our efforts to provide financial assistance to these ... universities, which is our exempt purpose."

"The thrust of these proposed guidelines ... misstates the law, perverts policy and shows little, if any, understanding or guidance in corporate donation/sponsorship in the collegiate athletic field," attorney Philip R. Hochberg wrote on behalf of the Division I-A Athletic Directors Association.

Meanwhile, friends of college football went to work within the halls of Congress.

Sen. John Breaux, (D., La.) introduced a bill to protect corporate payments to "qualified athletic event activities."

Rep. Ed Jenkins, (D., Ga.) introduced legislation to bar the IRS from taxing sponsorship payments to bowls and other big-time sporting events.

"The guidelines threaten the vitality and viability of practically all tax-exempt entities and their local and national educational and charitable purposes," Jenkins said at a hearing last July.

At least one of his colleagues remained unconvinced. "The Treasury is not saying that county fairs ... should not be entitled to special tax treatment. What they are saying is that the college bowl system has changed dramatically in the last 10 or 15 years ... way beyond what is appropriate for education," said Rep. Mike Andrews, (D., Texas).

Initially, IRS officials held their ground, saying they were prepared to take the heat.

"Maybe that's just the price we have to pay to get the higher level of voluntary compliance. Maybe we will have to draw a line a little inside where it could be drawn," Marcus Owens of the IRS said in a June speech to the Washington Bar Association.

And maybe not.

A month later, IRS conducted an unusual three-day hearing on the proposal, during which it heard numerous complaints. Months passed without word on when the guidelines would become final.

On Jan. 19, the IRS issued yet *another* set of proposed regulations. Under them, a corporate sponsor may enjoy nearly unfettered publicity without jeopardizing the tax exemption of bowl organizations. A corporate sponsor may:

- Demand that its name be used as part of the event.
- Put its logo around the stadium, on programs, on the playing field, on the players' uniforms.
- Require that the game be televised.
- Make sure that the cameras periodically show the corporation's logo/name.

Under the IRS's most recent proposal, these actions are not considered advertising.

■

And then there is the case of the IRS and United Cancer Council.

The council was organized in 1963 by about 80 groups that had split off from the American Cancer Society. For 20 years, it relied on dues and contributions. But in 1984, the council entered a five-year agreement with a Washington fund-raising firm, Watson & Hughey Inc., to solicit donations by direct mail.

In November 1990, the IRS revoked the tax-exemption of the Cancer Council, contending it was operated for the private interest of Watson & Hughey, which purportedly received 90 percent of the money raised.

Only about 10 percent of the United Cancer Council's money was used for charitable purposes, and its educational mailings were insignificant, the IRS maintained. Attorneys for the council say the contributions were greater.

In June 1990, the United Cancer Council filed a voluntary petition in bankruptcy, listing the IRS as a priority creditor. Less than a year later, it filed a petition in U.S. Tax Court in Washington challenging the IRS's decision to revoke its exemption.

Before the case went to trial, a letter was circulated by the Nonprofit Sector Legal Defense Fund, soliciting contributions for the lawyers representing the United Cancer Council and asking concerned charities to lobby the tax court.

The letter accused the IRS of a "dangerous, blatant power grab" and said that if the service prevailed, it "would win the power to dictate how you run your exempt organization — and the power to put your organization out of business!"

Signed by the United Cancer Council's lead attorney, Leonard J. Henzke Jr., the letter prompted a strong protest from the IRS, which asserted that it "wildly misrepresents" the agency's motives. It also drew a rebuke from the Tax Court judge, Herbert L. Chabot, who said the letter besmirched the court.

The case is pending.

In a speech in September, IRS associate chief counsel James J. McGovern attacked "confrontational" tactics now being used by some nonprofit groups and their lawyers. Citing the corporate sponsorship issue and United Cancer Council case, McGovern said these were examples of "how the game is being played in the nonprofit sector today."

■

It isn't entirely surprising that the IRS rarely revokes the exemptions of nonprofit organizations.

Revocations are so rare in fact that the Internal Revenue Service said it couldn't provide a list of nonprofits that have lost their exemptions.

"I have been told we don't keep them that way," IRS spokeswoman Johnelle Hunter said.

The IRS has revoked just one nonprofit hospital's exemption in the last 10 years — a period when hospitals poured more than $1 billion into commercial activities and expanded greatly.

IRS officials have said they are reluctant to revoke hospitals' exemptions because of the potential harm to communities. In essence, they say the penalty is so onerous they can't realistically use it.

The agency's choice is either to back off or to try to negotiate with the offending organization what is called a closing agreement — similar to a consent agreement. Increasingly, the agency is choosing the path of negotiation.

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But the negotiations can be painfully slow. Witness the IRS's extraordinary dealings with the Howard Hughes Medical Institute.

The facts of the case, culled from court documents, correspondence and tax returns, are these:

As far back as the mid-1950s, the IRS raised questions about the tax-exempt status of the Howard Hughes Medical Institute, eventually ruling in 1955 that it did not qualify as an exempt medical institute because it did not spend enough money on research.

In fact, revenue agents concluded, the institute was actually an elaborate tax shelter for billionaire-industrialist Howard Hughes, who created the Bethesda, Md., nonprofit in 1953 and used it to shift taxable income into an exempt organization.

Incensed by the IRS's decision, Hughes hired the Washington law firm of Hogan & Hartson, which filed an appeal with the IRS. It was the first of a series of protracted negotiations with the agency.

In 1969, Congress passed a series of reforms intended to curb abuses involving tax-exempt foundations. One of them required foundations to spend an amount equal to 6 percent of their net charitable assets each year in order to retain their exempt status. The requirement was later reduced to 5 percent. Another reform imposed a 4 percent excise tax on foundation investment holdings, since reduced to 1 percent.

Attorneys for the Hughes Institute were still attempting to sort out its tax status when these reforms were passed. Their negotiations now took on added meaning.

If the institute were ruled to be a private foundation, it would be subject to the new spending rules and would have to dispense millions or lose its exemption.

On the other hand, if the IRS could be persuaded to declare Hughes a charitable medical research institute, it would have to spend only an amount equal to 4 percent of its net charitable assets each year. For the Hughes Institute, that translated to a substantial savings.

Once again, Hughes' attorneys and lobbyists went to work, writing letters to the Treasury and IRS and working the back channels of the Nixon White House. Included in a July 1971 letter from Hughes lobbyist Robert Bennett to White House Counsel John Dean was wording for a proposed grandfather clause to pending Treasury regulations that would have exempted the Hughes Institute from any spending requirements.

In August, Dean wrote Bennett a brief letter thanking him for "bringing this matter to my attention." He immediately asked Treasury officials to brief him on the case.

"The position of the Hughes Medical Institute is presently being given careful attention in this Department," Charles E. Walker of the Treasury responded on Aug. 17, 1971. "We were not aware of their circumstances when the regulations were proposed, and I personally have met with their representatives. ... No final decision has been made."

Treasury officials did not adopt the grandfather clause Hughes wanted. Nor did they declare the institute a foundation, which would have required it to increase spending dramatically. In essence, the institute was allowed to drift in nonprofit limbo, where it remained for the next 16 years.

Finally, 34 years after the Howard Hughes Institute was created, it entered a closing agreement with the IRS on March 2, 1987. The exact terms are secret. However, details are contained in financial attachments filed as part of the institute's tax returns.

According to those and other documents, the institute had to pay the IRS $35 million for past years; distribute an amount equal to 3.5 percent of its assets for medical research each year, and make supplemental payments for research of at least $500 million by 1997.

On its face, the agreement seems like a good deal for the Treasury. But closer examination shows that the Hughes Institute actually got off fairly easily.

For 16 years, while the negotiations dragged on, it was not subject to the 5 percent-a-year spending requirements of a foundation. Although $500 million sounds like a huge penalty, it pales in comparison with the Hughes Institute's vast, untaxed wealth.

In 1990, the institute earned $309 million in dividends and interest on its $5.7 billion in investments — enough to pay off the $500 million in just two years.

In 1992, the institute's holdings grew by 11 percent, and totaled $6.9 billion.

In brief press accounts of the settlement, institute president Donald S. Fredrickson praised the IRS as tough negotiators. But his satisfaction was apparent.

"It's been about 20 years and I think the service was tough, but I think they were pretty enlightened in the way it came out. We are not displeased with the result," he said.

■ **Tomorrow:** Million-dollar salaries, luxury cars and chauffeurs, maid service: Life at a charity isn't what it used to be.

Marcus S. Owens, head of the IRS's exempt organizations division, says that resolving issues can take years because of appeals available to nonprofits.

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For sale: Names of people likely to give money to charity

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS

Ever wonder why, when you give a donation to one charity, you're suddenly inundated with requests for money from other nonprofit groups?

It's no accident.

All those heart-rending pleas to save the whales and feed the starving children are part of a massive high-tech campaign that charities use to solicit funds.

A key element involves the buying and selling of donors' names — unbeknownst to the donors, but with the blessing of Congress — through a national network of middlemen-brokers.

Nonprofits refer to this practice as "renting" their mail lists.

Most donors have no idea their names are being sold. It's up to them to get their names off the list if they object.

It generates tens of millions of dollars in fees each year and results in a hefty chunk of the 12 billion fund raising letters mailed by nonprofits annually.

It works this way.

Say you want to raise $1 million to fight a particular disease. All you have to do is call a broker who specializes in nonprofit groups. He can arrange a deal with another charity to rent its donor list. You then tap those donors for money.

Your cost? That depends on how many names you want and the financial profile of the donors. The wealthier and more generous the donors, the more valuable their names.

Generally, prices range from about $15 per 1,000 donor names to more than $100 per 1,000, according to interviews and mail list catalogs.

Want the list broken down by zip code? No problem. By size of donation? Again, no problem.

Perhaps you want only the names of donors who've given in the last six months? That's no trouble, either.

For a modest fee, the list can be provided on computer tape. Mailing labels are available in a variety of preprinted forms. They run an extra dollar or so for every 1,000 names.

The Inquirer examined more than 100 mail list transactions as part of its study of the $850 billion nonprofit economy. Typical was one involving the American Heart Association.

In September 1989, the Dallas-based nonprofit used an Armonk, N.Y., broker to buy a computerized mail list from Disabled American Veterans, one of the largest participants in the mail list business. The list included names of all donors who had given at least $2 to the veterans group. Charge for the list: $82,528.81.

Charities say that if they didn't rent lists from time to time, their own donor lists would become outdated. After a time, they would be unable to raise sufficient funds to provide valuable services.

Disabled American Veterans, a congressionally chartered nonprofit organization with headquarters in Cold Spring, Ky., says the millions it has earned renting donors' names is critical to the services it provides 800,000 veterans.

Court records and IRS filings show that the group earned more than $16 million between 1974 and 1985 providing donor names from its computerized list of 6 million donors.

In 1988 alone, the Disabled American Veterans processed 418 list requests, generating $1.8 million in fees. Of that, almost $300,000 went to brokers.

Twice a year, the nonprofit publishes and distributes data cards listing its available donor groups and the charges for renting them.

Buying and selling donor lists comes at a price — the donor's privacy. Most donors have no idea their favorite charities sell their names and addresses to other groups. If donors object, it's up to them to make sure their names are removed from trading lists.

The federal government is of little help. Congress and regulators have adopted a series of contradictory policies about privacy rights of donors.

The government prohibits nonprofits from disclosing the names of some donors in their public tax returns to protect the donors' privacy. But then the government allows charities to buy and sell names and addresses of these same donors to anyone who has the cash.

Recently, the Federal Communications Commission adopted rules prohibiting telemarketers from calling customers before 8 a.m. and after 9 p.m. Among the groups exempted from the new regulations: Charities and other nonprofits.

Asked the rationale for exempting nonprofits, a spokeswoman responded:

"I know what the answer is going to be. They're going to say it would drive them all out of business."

The spokeswoman then chuckled and said:

"Well, obviously there's been some lobbying going on."

Charities pay no taxes on most of the fees they earn from selling donor lists. The exception: when they sell their lists to profit-making firms. Then they must pay taxes. Such sales account for about 20 percent of all transactions.

Charities used to be required to pay taxes on all their income from list sales. In 1986, Congress amended the tax code as a result of lobbying from nonprofits to exempt income from sales to other nonprofits.

Congress adopted the change over the objections of the Internal Revenue Service and U.S. Treasury, which contended that buying and selling donors' names was a commercial business.

It is a big business, too.

In 1991, the Smithsonian Institution in Washington collected nearly $3.3 million from renting its mailing lists and the National Audubon Society made $596,000. Three years earlier, the March of Dimes Birth Defects Foundation made $1.2 million renting its list.

For more than a decade, the IRS and the Disabled American Veterans have been involved in a legal dispute over income from donor lists. The IRS challenged the more than $16 million in donor list fees the Disabled American Veterans earned between 1974 and 1985.

Initially, the U.S. Tax Court ruled that the fees were not taxable. But the Sixth Circuit Court of Appeals reversed that decision in July 1991. The legal dispute continues.

Other nonprofit groups have from time to time found themselves embroiled in struggles with the IRS over list rentals.

In 1991, the IRS sent the Sierra Club a bill for $187,759 in back taxes for 1985 to 1987. Some of the bill was for income the club earned by selling donor names and commissions from affinity credit card arrangements with its members.

In an appeal filed with the U.S. Tax Court, Sierra Club attorneys argued that the income was not taxable.

The Philadelphia Inquirer

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Warehouses of Wealth: The Tax-Free Economy

Fifth in a series.

Wanted: Top executive to run a nonprofit organization. Salary: $350,000 to $400,000 a year, plus bonus. Perks: Luxury car, country-club membership, interest-free house loan. Domestic help provided.

In high-level jobs at nonprofits, charity really pays

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS

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As the head of one of Philadelphia's largest and most prosperous businesses, Edmund F. Notebaert is paid $413,200 a year in salary and benefits. He drives a Mercedes provided by his employer and lives in a $550,000 house, bought with a no-interest loan from his corporation.

Notebaert's profession? He runs Children's Hospital of Philadelphia, a nonprofit institution that is exempt from federal, state and local taxes.

His is one of the higher-paying jobs in the Philadelphia area's $18 billion tax-exempt economy.

High compensation is not unusual, though.

Not among people like Iqbal Paroo, Gregory R. Anrig or Richard D. Breslin.

Don't recognize those names? Many executives of nonprofit institutions aren't well known. Even less is known about their pay and perks.

As president of Hahnemann University, Paroo is paid $493,898 a year in salary and benefits.

Anrig, who heads the Educational Testing Service near Princeton, gets $383,968 plus use of a spacious house on the fringe of his organization's 351-acre campus.

Breslin, president of Drexel University, receives $400,189, including use of a university-owned house in Bryn Mawr worth $570,000 and a Lexus, maid service and membership in two social clubs.

Then there's George H. Schmidt. He resigned as president of Main Line Health Inc., the nonprofit parent of Bryn Mawr, Lankenau and Paoli Hospitals, in 1991. He had served 2½ years. Schmidt's severance package: $506,213.

Across America, executives of many nonprofit organizations are getting large sums in salary, bonuses, benefits and deferred compensation, an Inquirer examination of 6,000 tax returns of exempt organizations shows. Some get more than $1 million.

Officials say the compensation levels are necessary if nonprofits are to compete with for-profit businesses to get executives of the highest caliber.

There is a central distinction, however: Salaries, mortgage loans and other perks given to executives of nonprofit institutions are subsidized by taxpayers.

Americans reacted with surprise — in some cases anger — when it was disclosed last year that William Aramony, president of United Way of America, had been paid $463,000 a year. He resigned in February 1992 and United Way undertook a concerted effort to rebut the impression that charitable donations were financing a lavish lifestyle for managers.

An 18-month study of nonprofit organizations by The Inquirer indicates that Aramony's pay package was not unusual.

The study — which also included an examination of court records, internal

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Philadelphia Inquirer April 22, 1993 p. A18

Pay and perks increase with nonprofits' growth

EXECUTIVES from A1

documents and government audits — shows that the image of officials of nonprofit organizations as low-paid, self-sacrificing managers is woefully out of date:

• Nearly half of the 25,000 executives and employees listed on the IRS returns were paid at least $100,000 a year.

• More than 200 were paid $450,000 or more.

• Nine executives received salary, bonuses and benefits exceeding $1 million, placing them in the top 1 percent of all taxpayers.

• Many large nonprofits commonly rewarded executives with cash bonuses and incentives based on the financial performance of their organizations, just as for-profit companies do. One large New York hospital paid its new president a $1 million "signing bonus."

• Retirement and severance pay for executives have soared. When University of Pittsburgh President Wesley W. Posvar retired in 1991, he received a compensation package worth $3.3 million, plus a pension of $201,600 a year. Following a public outcry, the pension was reduced to $141,600 a year.

• Charities and other nonprofits have given millions of dollars in low-interest or no-interest loans to executives to buy houses, redecorate residences, join country clubs or pay for children's schooling. In 1991, UCLA Chancellor Charles E. Young received $995,000 in low-interest loans to buy a $1.17 million house 35 miles from campus.

• Dozens of universities and hospitals provided free housing, food and liquor, domestic help, fresh-cut flowers, vacation junkets and gifts to executives. New England Medical Center in Boston spent more than $70,000 in 1991 redecorating its president's office.

• Executives of many large nonprofits were provided luxury cars or generous auto allowances. An executive of the J. Paul Getty Trust drove a $36,000 Jaguar, the president of the National Academy of Sciences was chauffered around Washington in a luxury car and the YMCA Foundation in Boston spent $986,643 on auto leases for its doctors.

• Entertaining by executives was a big expense at many nonprofits. Between 1986 and 1990, Blue Cross of Western Pennsylvania spent $377,101 to rent a skybox at Three Rivers Stadium, buy tickets to sporting events and pay country-club dues for top executives. Ratepayers picked up the tab.

• Seminars, conferences and staff development meetings — sometimes in exotic places — have become routine items. The Devereux Foundation in Devon flew 30 executives to Key West for a week of planning and rest, including a catered sunset yacht cruise. Cost excluding airfare: $9,000.

Pay and perks like these have grown over the last two decades as nonprofit institutions have grown — at a rate four times the rest of the economy. Nonprofits now control assets worth at least $850 billion.

The growth in nonprofits has created more than 3 million jobs. That has helped ease the impact of the decline of American industry and has elevated incomes of many workers, particularly in health care.

At a price. This economic transformation has cost federal, state and local governments — ultimately, taxpayers — more than $36 billion a year in lost taxes.

All this has occurred largely without notice, forethought or debate over the implications for the economy or public policy.

And executive compensation at nonprofits does have public policy implications.

Take health care. At a time when 37 million Americans cannot afford health insurance, more than 1,000 executives and doctors at nonprofit hospitals and insurance plans were paid salaries ranging from $200,000 to $1.2 million.

"A lot of people are being priced out of health-care coverage. What people get paid — whether it's physicians or administrators of hospitals or CEOs of insurance companies — is a factor," said Ron Pollack, executive director of Families USA, a Washington advocacy group. "Somebody has to foot the bill for these salaries, and that somebody is you and me."

At for-profit companies, such expenses come out of earnings of shareholders, who, theoretically at least, can object. In nonprofit organizations, there is often little oversight.

"The problem with nonprofits is that there are no shareholders to serve as a brake. There's no one there unless there is a responsible board of directors or, at last resort, the IRS," IRS executive Jay Rotz said in 1992.

Until recently, the Internal Revenue Service paid little demonstrable attention to the extraordinary increases in executive pay packages among large nonprofit groups.

IRS officials now say they have begun to scrutinize executive salaries in their audits of Form 990s, the annual statements each nonprofit must file with the IRS.

Yet the agency has not conducted a detailed study of executive compensation in tax-exempt groups.

By its own admission, the IRS is reluctant to challenge big salaries unless it can prove that executives are unfairly using their positions to enrich themselves. The agency's top regulator of nonprofits acknowledges that the whole salary area "is very gray."

One reason: There are no established guidelines. Another: Inadequate staffing. IRS audits of tax-exempt groups declined by half in the last decade.

The IRS has received little guidance from Congress. There has not been a major congressional hearing on executive pay of any sort in a quarter-century, let alone on what IRS should consider appropriate pay.

State and local agencies have done little. Most are understaffed or lack the expertise and data to analyze nonprofits' pay.

In short, whatever accountability does exist stems from the nonprofit institutions themselves. It is not always rigorous.

Many of the same board members who are expected to police the pay of nonprofit executives are themselves in business with their nonprofit organizations. Form 990s show hundreds of instances in which attorneys, accountants, financial advisers and consultants sell their services to the nonprofits they help to direct.

For example, Graduate Hospital in Philadelphia has leased medical and office equipment from a company run by a board member; has hired management, consulting and architectural services from other board members, and has contracted for TV services for patients and insurance coverage from still others.

Hahnemann University Hospital in Philadelphia contracted with board members' companies to lease equipment, provide credit lines, operate food services, and provide telephone service, financial management and computer information services.

A nonprofit business in Montgomery County that develops retirement homes paid more than $4 million a year in fees to a management company owned by a member of the board. Richard S. Coons was both chairman of the board of the nonprofit Adult Communities Total Services Inc. and president of the for-profit Total Care Systems Inc.

In June 1990, the management company was sold for $10.3 million to a Kennett Square nursing home chain. Genesis Health Ventures Inc. obtained the right to be the "exclusive manager and developer" of the nonprofit's expanding group of retirement centers.

In each of these examples, officers of the nonprofits say the transactions were conducted at arm's length and were disclosed to other board members.

It is impossible to say how often such business arrangements occur. Many nonprofits do not report instances of self-dealing or do not provide financial details. Or they conduct such transactions through subsidiaries and for-profit companies, outside the reach of disclosure rules.

"Trustees too often are on the board simply as fund-raisers, or worse yet, as vendors of legal, financial, construction, real estate, medical and other services," Nancy B. Kane, a professor at the Harvard School of Public Health, recently testified before Congress.

■

Officials of large tax-exempt groups maintain that big salaries are not at odds with the special social mission of nonprofits or their privileged tax-exempt status.

They offer four main arguments:

• Pay packages reflect increased duties. Today's executives have to deal with complex regulations, growing competitive pressures and are managing larger staffs and budgets.

• Large nonprofit organizations now compete with private firms for executive talent. So they must offer competitive salaries, benefits and perks if they are to attract managers of superior ability.

• Nonprofit executives travel in the same corporate circles as their for-profit counterparts and play a key role in fund-raising.

• Increasing numbers of executives move back and forth between nonprofit and for-profit organizations. As they do, differences in salaries tend to disappear.

Take John Gavin, who is paid $519,000 as chairman of the Century Council, a Los Angeles nonprofit funded by the liquor, beer and wine companies to combat alcohol abuse and deflect criticism of the industry. Gavin has been a movie actor, Ronald Reagan's ambassador to Mexico and a businessman.

"For a man of his stature, that is appropriate compensation," said Tom Ross, a senior

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vice president of Hill & Knowlton Inc., a public relations firm that represents the council.

It hasn't always been that way.

Once, for-profit and nonprofit groups had very different missions and operated in very different ways. For-profit companies built markets and made money. Their managers took risks and were well paid — or fired — for their performance.

The purpose of not-for-profit groups was to provide important community services that would otherwise fail to goverement.

Charities and nonprofits relied on contributions from the public and used the money to provide free services — what most Americans think of as charity. The tax exemption was granted in recognition of these services.

> Today, many large nonprofits are indistinguishable from for-profit companies. They make millions of dollars in profits. They have millions of dollars in stocks, bonds and other investments.
>
> And instead of relying on donations, they charge for their services, just like any other business, or are reimbursed by the government. Often they provide little or no charity.

"It used to be that the not-for-profit sector was its own world. You signed on after you got out of college, like if you joined the government, and you stayed there," said Robert C. Ochsner, director of compensation for Hay Associates, an employee benefits firm in Philadelphia. "There also was the realization that you never expected the same money you might earn in the for-profit world.

"Now we see people are crossing over. It's more common for people to go out of the not-for-profit to the for-profit sector, but it also works the other way around. Therefore, the markets are moving toward each other and the pay is catching up."

In some cases, the pay exceeds compensation of executives of commercial companies. A 1992 Hay survey found that the base pay of hospital executives was on average 2 percent higher than for executives at industrial firms of similar size.

Not everyone is part of this trend, or agrees with it.

James Osborne, national commissioner for the Salvation Army, believes that the special mission of nonprofits separates them from profit-making companies. He is paid $53,000, including benefits, for overseeing an organization with a $1 billion budget.

"I really can't speak to why other organizations pay what they do. But I can tell you that people who come to work at the Salvation Army don't come into this work because they are looking for money. If that was our overwhelming passion in life, we would go elsewhere," Osborne said.

■

The rapid increase in compensation coincides with the growth in revenues and wealth of large tax-exempt groups in the last two decades, especially during the 1980s.

The tax returns of nonprofit groups — they are required to file IRS Form 990s, even if they have no taxable income — show that

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pay packages for executives have far exceeded those of other workers as nonprofits have expanded, diversified their services, and become more commercial.

Consider a few examples, culled from tax returns of hospitals in the last decade.

• In 1981, the president of Thomas Jefferson University was paid $143,000. A decade later, the president received $399,196, including benefits and other allowances worth $109,196. In 1981, the president of Hahnemann University received $135,415. A decade later, the compensation was $493,898.

• In 1981, the president of Children's Hospital received $141,165. In 1991, he was paid $433,200.

In the same period, the average salary of workers in Philadelphia rose from $16,231 to $26,456.

Now consider how these three hospitals grew between 1981 and 1991.

Thomas Jefferson University's revenues rose from $184 million to $550 million. Hahnemann University's revenues rose from $153 million to $619 million. Children's Hospital's rose from $66 million to $296 million.

"Many tax-exempt organizations are very large and complex. Whether the compensation package paid to the chief executive is reasonable would depend, I think, on looking at a number of factors," said Marcus S. Owens, director of the IRS's Exempt Organizations Technical Division. "What are the responsibilities? What are the decisions? Does it involve large amounts of money?"

"I see no problems in paying an executive a livable salary. In fact, I think you have to if you are going to run the business successfully — and a nonprofit is a business," said Pamela Rainey Lawler, founder of Philabundance, a Manayunk charity that distributes free food to shelters and social agencies.

"But there's a big difference between a livable salary and paying someone hundreds of thousands of dollars," she said. "Running a nonprofit is a matter of public trust. I'm afraid some people are getting removed from what they are doing. They're becoming insulated as managers and executives."

Rainey Lawler was executive director of Philabundance from 1984 until July 1992. Her salary never exceeded $25,000. She now serves as unpaid chairwoman.

■

There is little question that executives of nonprofit organizations shoulder more responsibilities than they once did. But comparing their salaries with executives in for-profit companies may not be the best way.

Because one reason for the tax exemption is relieving the government of a burden, it might be more appropriate to compare these executives with top government officials.

How do they fare?

In 1990, Secretary of State James A. Baker was paid $99,500. The chief justice of the United States, William H. Rehnquist, received $124,000. And in 1992, Philadelphia Mayor Rendell earned $104,500.

By comparison, the lowest paid executive of a nonprofit hospital in Philadelphia and its Pennsylvania suburbs received $98,000 in 1990. Only eight hospital executives were paid less than Rehnquist; 40 were paid more.

Or apply the President's test. As chief executive of the United States, Bill Clinton is paid a salary of $200,000, plus $50,000 in expenses. The President also gets chauffeur service, housing, maid and valet, personal security and extensive travel, at no charge.

Still, compared with many nonprofit executives whose pay and perks were listed on tax returns from 1989 to 1991, the President's compensation seems modest. For example:

> • Richard Schweiker received a top salary of $61,000 a year as a U.S. senator from Pennsylvania in 1980. These days, as president of the nonprofit American Council of Life Insurance, a lobbying group, Schweiker collects $716,000 in salary and benefits — more than 3½ times the President's salary.
>
> • Gilbert M. Grosvenor, president of the National Geographic Society, received $419,691 in salary and benefits.
>
> • Peter J. Liacouras, president of Temple University, received $407,059 in salary and benefits in 1991, including a $16,000 housing stipend. He is one of the highest-paid university presidents in the nation.
>
> • James S. Todd, executive vice president of the American Medical Association, received pay and benefits totaling $528,496.
>
> • Cathleen Black, former president of USA Today, received $600,000 as executive director of the American Newspaper Publishers Association, a tax-exempt trade and lobbying group. The publishers also gave Black $300,000 for stock rights she forfeited when she left USA Today.
>
> • William W. Whaley, a division president at Children's Television Workshop, producers of Sesame Street, was paid $671,221.
>
> • Jack Valenti, president of the Motion Picture Association of America, was paid $776,689.
>
> • John W. Rowe, president of New York's Mt. Sinai Hospital and two affiliates, received $891,385.

At least 1,000 employees of nonprofit organizations received more than the President of the United States. Two hundred collected at least twice the President.

■

Then there's the nonprofit millionaires' club.

NFL Commissioner Paul Tagliabue was paid $1,511,731 in salary and benefits in 1991.

His predecessor, Pete Rozelle, was paid $2,937,344 by the NFL in 1990.

Rozelle resigned as commissioner in 1989, but according to the league's tax return, he served as "commissioner consultant" in 1990. He received $830,000 in 1991 and $710,000 in 1992.

In 1990, Walter M. Cabot earned $1,486,446 working for an investment house — a private, tax-exempt investment house.

Cabot was president of Harvard Management Company Inc., which occupies the entire 15th floor of the Federal Reserve's office tower in Boston's financial district. The company describes its charitable purpose as "providing investment research, advice, counsel and management" to Harvard University. Cabot has since left the company.

Two other Harvard Management employees made more than $1 million. In 1989, Michael Eisenson and Scott Sperling were each paid $1,066,042. They ran Aeneas Group Inc., a subsidiary that invests in real estate, start-up companies and corporate takeovers.

The New York banking and insurance scene also provided several million-dollar nonprofit executives. In 1990, Clifton R. Wharton Jr. was paid $1,283,650 as chairman and chief executive officer of Teachers Insurance & Annuity Association and the College Retirement Equity Fund. James S. Martin, chairman of the retirement fund's finance committee, received $1,068,529.

Formed in 1918 to pool pension contributions of university and college teachers, TIAA-CREF today is the world's largest pension fund, with assets of $100 billion.

Records show the two companies paid more than $30 million to 167 senior managers in 1990. Thirty-seven executives were paid $200,000 or more, including four who made between $500,000 and $1 million.

Not far from TIAA-CREF's Manhattan offices is the headquarters of Mutual of America Life Insurance Co., a tax-exempt insurer with nearly $5 billion in assets. In 1991, Mutual's chairman and chief executive officer, William J. Flynn, was paid $1,058,702.

Another nonprofit millionnaire: Paul A. Marks, a physician who is president and chief executive officer of Memorial Sloan-Kettering Cancer Center in New York and its affiliates. In 1991, Marks was paid more than $1 million in salary and benefits.

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Museums-turned-merchandisers: Where does tax exemption end?

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS

A Delaware retailer brings in $17 million a year selling expensive strings of pearls, faux tortoise rattan tables and other unusual gifts through 12 million catalogs mailed each year.

The profit margin on goods sold is huge — 65 cents on every $1 taken in. If shoppers pay with credit cards, they can call a toll-free number seven days a week from 8 a.m. to midnight. Or they can visit one of the retailer's outlets just north of Wilmington or in Alexandria, Va.

What makes this retailer different from other trendy merchandisers? It is a nonprofit, tax-exempt museum.

And it gets a break of up to $1 million a year on postage for its catalogs — subsidized by the U.S. government and, ultimately, you.

The tax-exempt Franklin Institute took in more than $450,000 when it showed "Rolling Stones at the Max" for seven months in its Tuttleman Omniverse Theater.

This is the Winterthur Museum and Garden, where revenue from the sale of merchandise is 17 times the amount collected in admissions. Where two of the five highest-paid employees are the marketing director ($92,127 salary) and direct-mail director ($87,580 salary). Where officials have just begun to carefully consider whether the profit they make on merchandise sales should be taxed.

"We hadn't looked at it as closely until recently. Most things we sold we considered to be closely related to our [tax-exempt] mission," said Winterthur controller Richard F. Crozier.

In 1991, Winterthur had gross income of $11.2 million on $17.1 million in merchandise sales. For the first time ever, the museum reported $3.7 million as "unrelated business income" — income not covered by its tax exemption. After deducting expenses, the museum paid about $18,000 in federal income taxes.

In 1990 its gross profit on these sales was $8.8 million and in 1989 it was $9 million — all untaxed.

Museum or merchandiser?

At times, it's tough to tell.

Museums and other cultural institutions increasingly have gone commercial over the last decade as they try to raise money for their programs.

The giant Metropolitan Museum of Art in New York now has a chain of 13 retail outlets from California to Connecticut, many in malls. The museum also mails out millions of catalogs each year.

In 1991, the Metropolitan Museum reported $45.5 million in gross profits on $87 million in merchandise and food sales. Those sales were nearly 10 times what it collected in admissions.

Out of all its revenues — $183 million — the museum declared $296,191 as "unrelated business income" and subject to federal income tax and paid $61,810 in tax.

When a museum opens a store outside the museum, for-profit competitors cry "foul."

"We feel the playing ground currently is not level," said William Edwards, vice chairman of The Museum Co., which operates a national chain of 32 commercial stores that sells the same kinds of goods as museum shops.

Edwards doesn't object to museum stores at museums. But it's different when the museum opens a store in a mall, he said.

"They should be treated by the law like any private retailers that choose to open a store 1,000 miles from home," he said.

Edwards said that in at least five cases — two in Chicago and one each in Detroit, Atlanta and Los Angeles — The Museum Co. had a "handshake" agreement with a mall manager to rent space, then was bumped by a museum, which could pay higher rents because of its tax exemption. The museums' local social connections helped, too, Edwards said.

"It never occurred to us that museums would take advantage of their tax exemptions," he said.

While some nonprofit museums compete with retailers, others are competing with for-profit movie theaters.

In Philadelphia, the Franklin Institute opened its wraparound Tuttleman Omniverse Theater in 1990. Like other theaters in museums and aquariums, this 350-seat theater has shown educational science films, such as *Tropical Rainforest*.

However, between Thursday and Sunday nights last year, some shows were sold out. The movie was the *Rolling Stones at the Max*, which over seven months pulled in 30,498 people at $15 a ticket (including the option of also browsing the museum).

Co-sponsored by classic rock radio station WYSP-FM, the Stones movie opened last May with advertisements in the newspaper movie section touting: "See it larger than life on the four-story wraparound Omnimax screen with 56 speakers of floor-rattling digital sound!"

The Franklin Institute was by no means the only tax-exempt organization that made money from the Stones film. Museums and science centers across the nation showed the movie to boost evening attendance, said Susan Mander of Toronto-based Imax Corp., the film's distributor. So far, more than a million people have seen it, accounting for $13 million in receipts.

The Franklin Institute did not consider the Rolling Stones movie commercial and is not declaring its receipts from the movie as unrelated business income, said spokeswoman Elaine Wilner. Some museum programs were built around the movie, she said, and people who attended were permitted to visit other museum exhibits.

Just less than half of the $450,000 gross went to Imax. The balance, about $237,000, went to the museum.

Indeed, the museum sees all of what it does as program-related. In 1992, the Franklin Institute did not declare any of its $24 million in revenues, or $3.1 million in profit, subject to federal income taxes.

Cultural attractions are no small part of the economy. A 1989 study, which focused on 28 cultural organizations in the area, found their annual ticket sales and admissions totaled $20 million. And audience spending on related activities, such as dining and parking, added up to another $33 million, according to the study sponsored by the Pew Charitable Trusts.

But looking at revenues only from admissions understates the size of the cultural sector. For example, the four museums near the Benjamin Franklin Parkway — the Philadelphia Museum of Art (admission: $6), the Franklin Institute ($9.50), the Academy of Natural Sciences ($6) and the Please Touch Museum ($5) — had total revenues of $68 million in 1990. The figure includes admissions, merchandising, donations, grants, dividends and interest.

Nevertheless, museum fees have been rising. To take a family of four — two children and two adults — in the Franklin Institute for the combination package of museum, Omni theater and planetarium costs $54. And that's without the hot dogs.

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1,000 executives make more than Bill Clinton

Continued from preceding page

In 1988, when Marks became the hospital's president, he got a $1 million "signing bonus" in return for a pledge to remain through 1994, it was reported.

How does the IRS's Owens explain the phenomenon of nonprofit millionaire?

"Luckily, I don't have to," he said. "What our auditors would look at is how large is the tax-exempt organization, how much responsibility is involved. Is it a true job?"

■

Directors of some tax-exempt groups also receive large sums of money — another indication of how nonprofits have changed.

Board members used to be called trustees and served a basic role: They were guardians of a community asset, entrusted with the responsibility of ensuring a charity's integrity.

Today, many large nonprofits refer to their governing bodies as boards of directors, as commercial businesses do. And like directors of publicly held companies, these board members are paid to attend meetings. They often are provided with perks of office.

The financial arrangements are often murky. What details do get out often are buried in the back pages of the tax returns. These show that nonprofits not only match private companies when it comes to directors' pay, they occasionally exceed it. Consider the Howard Hughes Medical Institute.

In 1990, the research facility in Bethesda, Md., gave nine directors $335,002 in trustees fees — an average of $37,222 each.

In 1990, the American College of Physicians, based in Philadelphia, spent $958,077 on directors' fees and expenses. The largest fee, $41,500, was paid to Dr. Eugene A. Hildreth of Reading, chairman of the board of regents. On the group's Form 990, where a description of each board member's activities is required, the entry for Hildreth and his colleagues was identical: "minimal time."

"That's a mistake," said Dr. John Ball, executive vice president. "Many of our trustees devote a substantial amount of time. These fees are a way of compensating them for their lost practice time."

Mutual of America, the New York nonprofit insurance and pension company, paid its directors $228,950 in 1991. The highest paid: William Aramony, former head of United Way. He got $31,000 to attend eight meetings, an average of $3,875 a meeting.

Aramony has been a director of Mutual of America since the early 1970s. During that time, the insurance company sold millions of dollars worth of services to various United Way groups around the country.

The John S. and James L. Knight Foundation, a tax-exempt organization created by the Knight brothers, who were executives of Knight Newspapers (now Knight-Ridder Inc., corporate parent of The Inquirer and Daily News), paid its trustees between $1,500 and $19,500 in 1991. The average: $10,750.

The Gannett Foundation, set up by the nation's largest newspaper group and later renamed The Freedom Forum, paid its part-time trustees between $8,333 and $98,833 in 1992. The average: $55,657.

By comparison, the average compensation for outside directors of the 150 largest industrial companies was $39,724, according to a 1991 survey by Hewitt Associates.

Officials say they pay directors in recognition of their growing responsibilities and workloads.

"I think almost every large foundation board pays its trustees," said Steven A. Schroeder, president of the Robert Wood Johnson Foundation in Princeton.

It "allows people who don't have great wealth to be able to do it," Schroeder said.

In fact, boards of most large foundations and nonprofits rarely include people who aren't wealthy, well-known in the business community, or have some other connection to the organization, an analysis of board memberships shows.

Schroeder acknowledged that his and many other boards often do not include representatives of the public.

"If you ask me how many paupers are on the board, I would tell you none. One of the things that happens is that boards often get set up to represent families or friends [of the original benefactor]. Friends of rich people tend to be rich people," he said.

■

These days, salary is only one part of executives' compensation.

In 1991, half of all nonprofit hospitals in America — about 1,600 hospitals — paid executives cash bonuses, according to a Hay Associates survey. The bonuses accounted for about one-quarter of total compensation.

Take Larry L. Mathis, president and chief executive officer of the Methodist Hospital in Houston. In 1992, he was paid a bonus of $138,555. Mathis' bonus accounted for 24 percent of his $584,930 in total compensation.

Nonprofit executives and benefits consultants say there is nothing wrong with tying an executive's pay to financial performance. It's a responsible way to achieve a variety of goals, they say.

The practice does raise questions about the motivation of executives, and it blurs the lines between nonprofit and for-profit organizations, others say. Too strong an emphasis on financial performance could diminish the very services for which a tax exemption was granted, these critics say.

Indeed, the use of bonuses has been singled out in several lawsuits challenging the tax-exempt status of a nonprofit organization.

"Incentives based on profit are directly contradictory to a lack of profit motive," Erie County Common Pleas Judge George Levin wrote in a May 1990 case involving Hamot Health Systems Inc. in Erie.

"Each executive who participates in these benefits knows that he or she will receive more money if the institution generates more profits. ... How is such a payment possible without a private profit motive?"

Court records in the Hamot case show that president Dana Lundquist received incentive pay of $41,557 in 1988 and $37,980 in 1989. That was in addition to salary of $189,900 in 1988 and $206,991 in 1989. Lundquist earned about $275,000 in 1991, a spokeswoman said. Lundquist resigned from Hamot in 1992.

Bonuses come in all shapes and sizes.

In 1989, Dr. Buris Boshell, part-time executive director of the Diabetes Trust Fund in Birmingham, Ala., was paid a one-time bonus of $300,000, in addition to his $100,000 salary.

A note attached to the group's 1989 tax return states that the trustees "voted the executive director a special one-time bonus in the amount of $300,000 for his past services to the trust fund. This equates to a salary of about $20,000 per year for the first 15 years of the trust fund, when the executive director served without compensation."

In an interview, Boshell said the trustees had given him the bonus when he took early retirement because his previous employer closed part of a diabetes clinic he ran at the University of Alabama at Birmingham.

"My board went to the university and explained that [early retirement] certainly would create financial distress for me," he said. "They asked for a golden parachute for me, and, to make a long story short, the university said 'no.' The board then decided that I should get $300,000 for the many, many years I had put into the clinic."

Today, Boshell runs a diabetes clinic for another Birmingham hospital and continues to earn $100,000 as a part-time executive director of the trust fund.

The nonprofit Devereux Foundation in Devon also has spent tens of thousands of dollars a year on executive bonuses based in part on financial performance.

Court records and interviews show that the foundation has paid senior executives cash bonuses ranging from $6,000 to $50,000. The largest went to Devereux president Ronald P. Burd, who received a $50,000 bonus in 1991, and total compensation of $281,622. Burd's pay package included a $6,000 car allowance.

In 1992, Burd's bonus fell to about $42,000. Devereux's trustees have since decided to eliminate bonuses based on financial incentives. "Quite frankly, I don't think it motivated our already really dedicated staff," Burd said.

Asked about the foundation's Key West outing and yachting cruise for 30 executives, Burd said it was "cheaper and also more productive" to hold the meeting in Key West than in the Philadelphia area.

Leaving a nonprofit also can be highly profitable.

When University of Pittsburgh president Wesley Posvar announced his retirement in 1991, following nearly a quarter-century at the school, it was disclosed that he would receive a $3.3 million annuity, an annual pension of $201,600, lifetime health coverage and use of a university office.

Some state legislators in Harrisburg cried foul. After all, Pitt was a nonprofit organization, not a Fortune 500 company, they complained. Such a generous retirement package sent the wrong message.

Pitt officials responded that Posvar had accepted a salary of $45,000 in 1967 when he arrived at the school, which was then heavily in debt. Under Posvar, Pitt had not only rebounded, it had thrived, they said.

Posvar eventually agreed to accept an an-

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nual pension of $141,600 and to repay low-interest mortgages from the university totaling $740,000. He said his retirement package was comparable to corporate executives.

Not to mention those of other university executives.

In 1992, the University of California voted its outgoing president, David Gardner, a lump sum retirement of $797,000, plus an annual pension of $130,000. Gardner, who also received generous housing loans, travel arrangements and other perks, was president of the university 10 years.

Transcripts of the board meeting at which Gardner's retirement package was voted show that some of the regents were worried about the potential for negative publicity.

"If the legislature gets hold of this ... when we're increasing fees ... it's very difficult to reconcile," regent Frank Clark said.

■

Large nonprofits often supplement income of key executives by lending them money — sometimes at little or no interest.

The IRS views such loans as part of executives' total compensation. It does not prohibit interest-free or below-market loans but takes them into account in considering whether compensation is excessive. "We put it all out there on the scale of reasonableness and see if it balances," Owens said.

The Inquirer identified more than 200 loans to executives, totaling nearly $20 million, made by charities and other nonprofit groups in the years 1989 through 1992, including mortgage loans made by universities to faculty members, the value of loans exceeded $250 million.

The majority were to buy houses. For instance, in 1990 Georgetown University lent its vice president for urban affairs, Samuel Harvey, $332,304 to buy a house. The 30-year mortgage was at 9.63 percent interest.

Two years earlier, the university made two loans totaling $751,880 to John Griffith, executive vice president of the university's medical center, to buy a residence. One loan for $107,500 carried a 5 percent interest rate. The other was a no-interest loan for $644,380.

In all, Georgetown listed $1,631,792 in loans to three senior officers in its 1990 IRS filing.

John Silber, president of Boston University, received three loans totaling $638,921 in the mid-1980s. One, for $138,921, was to buy a house and was interest-free, according to the university's tax return. The loan was issued April 15, 1983, and Silber did not have to begin making monthly payments of $2,315 until January 1992.

Another nonprofit organization that has made mortgage loans to officers and key employees is the National Collegiate Athletic Association, based in Overland Park, Kan.

Tax returns for 1990 listed $1,451,015 in outstanding loans to officers and employees. The single largest NCAA borrower was executive director Richard D. Schultz, who owed $247,016 on a mortgage loan. Schultz's salary in 1990 was $328,438.

The NCAA, which lists its exempt purpose as an educational association, oversees the sports programs of more than 1,000 universities and colleges. One of its roles is investigating schools for violations of NCAA rules.

In September 1992, it suspended Demetrios Dullose, an All-America linebacker at Notre Dame, for two games. Dullose's sin: accepting a $600 loan from two football boosters.

■

"Let's do all we can to relieve childhood suffering," said a recent fund-raising plea from former U.S. Surgeon General C. Everett Koop on behalf of Children's Hospital of Philadelphia.

"It costs over $267 million to run this hospital every year," another mailing said. "We can meet these expenses only with the support of caring, compassionate people. And that is why I hope you'll help us by making a donation of $20, $25, $50, or even $100 today."

Where does the money go?

In 1987, $600,000 was used by Children's Hospital's President Edmond Notebaert to purchase a $550,000 house in Chester County. The money came in the form of a no-interest cash loan made to Notebaert by the tax-exempt Children's Hospital Foundation.

Most charities that make loans to their officers describe them in their tax returns, as required by the IRS. Children's officials did not spell out terms of the Notebaert loan in their tax returns for the years 1987 through 1990.

There was no record made of the interest rate, the length of the loan or how it was secured. The only reference to the loan came in response to a form question about lending of money. There, hospital officials wrote "mortgage loan to president."

When first asked about the loan in December 1991, Notebaert responded, "We think we have provided the necessary disclosure and would prefer not to offer any more information." Notebaert declined several other requests for comment.

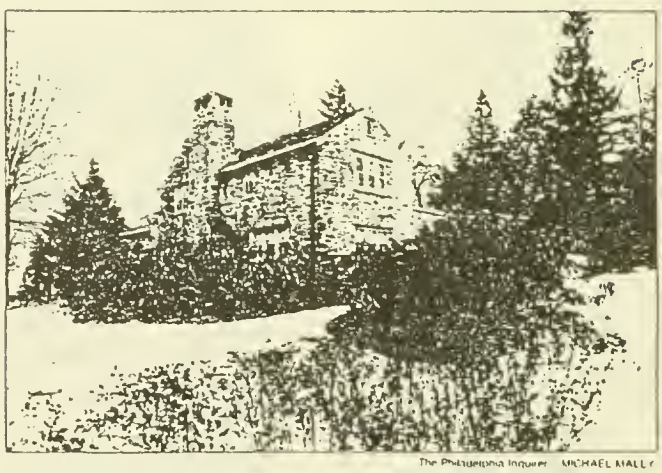
Property records in Chester County show that on July 31, 1987, he purchased a house on 3.4 acres in East Goshen Township. That day, Notebaert obtained a 10-year mortgage loan for $600,000 on the property from the tax-exempt Children's Hospital Foundation.

In March 1992, Children's officials reversed themselves and filed a schedule with a tax return for fiscal year 1991 disclosing the terms of the loan.

The return filed by The Children's Hospital Foundation described the loan as to "facilitate relocation to Philadelphia for employment." Notebaert is paying $2,500 a month on the loan, with the balance due Aug. 31, 1997.

Under "interest rate," the return notes 0%.

■ **Tomorrow:** For nonprofits, there's a vast pool of cheap money available for building. The money attracts all types ...



The Philadelphia Inquirer / MICHAEL MALLY

As part of his $300,189 pay package, Richard D. Breslin, president of Drexel University, gets to live in a university-owned house worth $570,000 in Bryn Mawr. He also has use of a Lexus and free membership in two social clubs.

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Pay Packages of Nonprofit Executives

Listed here are amounts of total compensation for executives of nonprofit organizations, as reported on Form 990s filed with IRS for the years noted. Not included on the list are individuals whose compensation is given in the accompanying article. The list, derived from 6,000 IRS forms, gives a representative sample of each major category of tax-exempt groups. Local organizations are in boldface type.

CHARITABLE

NONPROFIT ORGANIZATION / YEAR	NAME / TITLE	TOTAL COMPENSATION
American Cancer Society / 1991	William Cockrell / Executive Vice President	$148,500
American Heart Association /1990	Dudley Hafner / Executive Vice President	257,050
American Lung Association /1990	James A. Swomly / Managing Director	172,688
American National Red Cross / 1991	Elizabeth Dole / President	200,000
Arthritis Foundation / 1990	Clifford M. Clarke / President	155,194
Christian Children's Fund / 1990	Paul F. McCleary / Executive Director	119,231
Devereux Foundation / 1991	**John O'Malley / Vice President - Clinical Affairs**	**278,313**
Elwyn Inc. /1990	**Marvin Kivitz / President**	**128,000**
Epilepsy Foundation of America / 1990	William M. McLin / Executive Vice President	183,372
Fed. of Jewish Agen. Gr. Philadelphia /1990	**Robert Forman / Executive Vice President**	**168,211**
Federation of the Handicapped /1990	Milton Cohen / Executive Director	150,000
Girl Scouts of America / 1989	Frances Hesselbein / Executive Director	202,187
Humane Society of the U.S. /1990	John A. Hoyt / President	158,606
Inglis House /1989	**David Romanoff / Medical Director**	**142,003**
Lighthouse Inc. / 1991	Barbara Silverstone / Executive Director	132,063
March of Dimes Birth Defects Foundation / 1990	Charles L. Massey / President Emeritus	186,462
	Jennifer Howse / President	150,570
Mothers Against Drunk Driving /1990	Robert J. King / Executive Director	123,187
Muscular Dystrophy Association / 1991	Robert Ross / Executive Director	291,593
	Gerald Weinberg / Director of Field Organization	214,940
National 4-H Council / 1991	Richard J. Sauer / President	130,810
National Abortion Rights Action League / 1991	Kate Michelman / Executive Director	99,711
National Audubon Society / 1991	Peter A.A. Berle / President	145,384
National Easter Seal Society /1990	John Garrison / President	143,238
National Right to Life Committee / 1991	J.C. Wilke / President	110,525
National Wildlife Federation /1990	J.D. Hair / President	289,341
Nature Conservancy / 1991	John C. Sawhill / President	196,576
North Shore Animal League /1990	David J. Ganz / Executive Director	180,833
Philadelphia Corp. for Aging / 1990	**Rodney O. Williams / Executive**	**89,097**
Save the Children Federation /1990	James Bausch / President	229,304
Sierra Club / 1990	Michael L. Fischer / Executive Director	107,500
Sierra Club Legal Defense Fund / 1990	Fredric P. Sutherland / President	157,219
Southern Poverty Law Center /1990	Richard Cohen / Legal Director	122,036
Ellis Island Foundation / 1990	Stephen A. Birganti / President	157,658
UNICEF / 1991	Lawrence E. Bruce Jr. / President	175,500
United Negro College Fund / 1990	Christopher F. Edley / President	117,527
United Service Organizations (USO) / 1990	Charles T. Hagel / President	179,280
United Way of America /1990	William Aramony / President	413,463
United Way of S.E. Pennsylvania / 1992	**Ted L. Moore / President**	**205,348**
	A.J. Sassone / Vice President	**143,392**
	Francis A. Marzolf / Managing Director	**111,653**
Up With People /1990	J. Blanton Belk / President	141,750
YMCA - Philadelphia / 1990	**D. Allan Shaffer / President**	**154,145**

• FOUNDATIONS •

Thomas W. Langfitt
President
PEW CHARITABLE TRUSTS
$620,862

• FOUNDATIONS •

Franklin A. Thomas
President
FORD FOUNDATION
$545,255

• CHARITABLE •

Ben H. Love
Chief Scout Executive
BOY SCOUTS OF AMERICA
$252,358

• TRADE GROUPS •

Donald M. Fehr
Executive Director
MAJOR LEAGUE BASEBALL PLAYERS ASSOCIATION
$506,916

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FOUNDATIONS

NONPROFIT ORGANIZATION / YEAR	NAME / TITLE	TOTAL COMPENSATION
Alfred P Sloan Foundation /1991	Ralph E Gomory / President	$292,500
Andrew W Mellon Foundation / 1991	William G Bowen / President	443,485
Carnegie Corp of N.Y / 1991	David A Hamburg / President	499,497
	David Z Robinson / Senior Counselor to President	243,477
Commonwealth Fund / 1991	Margaret E Mahoney / President	300,558
Ford Foundation / 1991	John W English / Chief Investment Officer	506,235
Freedom Forum / 1992	Gerald M Sass / Senior Vice President	215,042
Henry J. Kaiser Family Foundation / 1991	Drew E. Altman / President	340,777
John, Catherine MacArthur Foundation / 1990	Adele S Simmons / President	349,144
J. Paul Getty Trust / 1991	Harold M Williams / President	509,011
Knight Foundation / 1991	James Spaniolo / Vice President	130,202
Kresge Foundation / 1991	Alfred H Taylor Jr / Chairman	256,667
Lilly Endowment / 1991	Thomas H Lake / Chairman	423,830
Pew Charitable Trusts / 1991	**Rebecca W. Rimel / Executive Director**	**227,369**
	Michael Rubinger / Associate Executive Director	**157,003**
Richard King Mellon Foundation / 1991	Mason Walsh Jr / Counsel	250,956
Robert Wood Johnson Foundation / 1991	Sidney F Wentz / Chairman	277,075
	William C Imhoff / Chief Investment Officer	272,874
	Steven A Schroeder / President	230,886
Rockefeller Foundation / 1991	Peter C Goldmark Jr / President	419,911
Sarah Scaife Foundation / 1990	Richard M Larry / President	346,747
William Penn Foundation / 1991	**Bernard C. Watson / President**	**185,000**
W K. Kellogg Foundation / 1992	Russell G Mawby / Chairman	392,946
	Norman A Brown / President	231,847

TRADE GROUPS, RESEARCH

NONPROFIT ORGANIZATION / YEAR	NAME / TITLE	TOTAL COMPENSATION
AFL-CIO / 1991	Lane Kirkland / President	$174,275
American Arbitration Association /1990	Robert Coulson / President	186,007
American Council of Life Insurance / 1991	W Kingsley / Executive Vice President	301,949
American Family Association / 1991	Don Wildmon / President	121,635
American Frozen Food Institute / 1991	Steven C Anderson / President	137,376
American Iron and Steel Inst / 1991	M Deaner / President	236,000
American Law Institute /1990	**Paul Wolkin / Executive Vice President**	**205,625**
American Management Association / 1991	Thomas R Horton / Chief Executive Officer	338,074
American Soc. for Testing & Materials / 1990	**Joseph C. O'Grady / President**	**121,401**
American Soc of Assn Executives / 1991	R W Taylor / President	325,098
Assn of American Public TV Stations / 1991	David J Brugger / President	161,314
Atlanta Comm for Olympic Games / 1992	William Payne / President	530,000
Biological Abstracts /1990	**H.E. Kennedy / President**	**152,252**
Charles Stark Draper Laboratory / 1991	Michele S Sapuppo / Director	290,320
College Football Association / 1991	Charles M Neimas / Executive Director	189,059
College Retire & Equities Fund /1990	C Oscar Morong Jr / Senior Vice President	825,691
Common Fund for Nonprofit Org / 1991	George F Keane / President	509,076
Conference Board /1990	Preston Townley / President	266,553
Consumers Union / 1990	Rhoda H Karpatkin / Executive Director	177,979
Cottonbowl Athletic Assn. /1990	Jim Brock / Executive Vice President	118,528
Cousteau Society / 1990	Jean-Michael Cousteau / Executive Vice President	166,427
Edison Electric Institute / 1990	T. Kuhn / Executive Vice President	209,324
Financial Accounting Foundation (FASB) /1990	O R Beresford / Chairman	414,218
	R C Lauver / Member, Fin Acctg Standards Bd	378,546
Free Congress Res & Educ. Foundation / 1991	Paul M Weyrich / President	179,209
Greater Philadelphia Chamber Commerce / 1990	**Charles P. Pizzi / President**	**129,990**
Heritage Foundation / 1990	Edwin J Feulner Jr / President	342,644
	Edwin Meese / Reagan Fellow in Public Policy	221,780
Independent Sector / 1991	Brian O'Connell / President	221,757
Motion Picture Assn of America / 1991	Myron Karlin / Executive Vice President	575,456
Mutual of Amer Life Insurance Co. / 1991	Joan Casson / Executive Vice President	264,652
National Academy of Sciences /1991	Frank Press / President	328,295
National Assn Manufacturers / 1990	Jerry Jasinowski / President	215,687
National Assn of Realtors / 1990	William D North / Executive Vice President	321,416
National Bureau of Econ. Res. / 1990	Martin Feldstein / President	222,600
National Cable Television Assn. /1990	James P. Mooney / President	448,433
National Education Association /1990	Keith Geiger / President	165,697
National Football League / 1992	Jay Moyer / Executive Vice President	380,000
National Football League Players Assn / 1991	Gene Upshaw / Executive Director	297,055
National Trust for Historic Pres. / 1990	J Jackson Walter / President	207,019
Nellie Mae Inc. / 1990	Lawrence W O'Toole / President	281,704
New York Shipping Assn / 1991	James A Capo / President	182,722
Newspaper Advertising Bureau / 1991	Leonard P. Forman / President	334,021
Penns Landing Corp. / 1991	**Dominic Sabatini / Managing Director**	**117,292**
Pennsylvania Compensation Rating Bureau / 1990	**Timothy L. Wisecarver / President**	**133,046**
Pennsylvania Economy League / 1991	**Dianne E. Reed / Executive Director - Eastern Division**	**86,750**
Philadelphia Conven. & Visitors Bureau / 1991	**Thomas Muldoon / President**	**170,081**
Poynter Institute for Media Studies / 1991	Robert J Haiman / President	163,481
	Roy Peter Clark / Dean	101,907
Princeton University Press / 1990	Walter H Lippincott / Resident Agent and Secretary	131,212
Professional Golfers' Assn. (PGA) /1990	Jim L Awtrey / Executive Director	235,072
Public/Private Ventures / 1990	**Michael A. Bailin / President**	**152,924**
Robert Morris Associates / 1991	**Clarance R. Reed / Executive Vice President**	**160,921**
Society of Automotive Engineers / 1990	Max E Rumbaugh Jr / Vice President	175,491
Southwest Research Institute / 1991	M Goland / President	459,695
SRI International / 1991	James J Tietjen / President	556,148
Sugar Association / 1991	Charles O Shamel / President	209,146
Teachers Insur & Annu Assn Amer. /1990	J Daniel Lee / Executive Vice President	681,063
Underwriters Laboratories Inc /1990	G T Caslino / President	197,528
United Nations Development Corp / 1991	Thomas Appleby / President	165,769
Universities Res Assn (Fermi Lab) / 1991	John S Toll / President	231,893
University of Pennsylvania Press /1990	**Thomas Rotell / Director**	**153,458**
U S Olympic Comm /1990	Harvey Schiller / Executive Director	253,635
	Baaron Pittenger / Executive Director	240,173
Wistar Institute / 1990	**Hilary Koprowski / Director/Professor**	**206,000**
Woods Hole Oceanographic Inst /1990	Craig E. Dorman/ Director	134,520

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Pay Packages of Nonprofit Executives

As reported on IRS tax forms. Boldface denotes local nonprofits.

EDUCATION

NONPROFIT ORGANIZATION / YEAR	NAME / TITLE	TOTAL COMPENSATION
American College /1989	**Edward G. Jordan / President**	**$132,308**
American College Testing Pgm (ACT) / 1991	Richard L. Ferguson / President	281,194
Amherst College / 1991	Peter R. Pouncey / President	172,700
Barnard College / 1991	Ellen Futter-Shutkin / President	261,748
Bowdoin College / 1991	Robert H. Edwards / President	173,321
Brigham Young University / 1991	LaVell Edwards / Football Coach	150,025
Bryn Mawr College / 1991	**Mary Patterson McPherson / President**	**146,844**
Bucknell University /1990	Gary A. Sojka / President	147,735
Carnegie Mellon University / 1990	Richard M. Cyert / President	248,133
Colby College / 1990	William R. Cotter / President	195,337
College Entrance Examination Bd / 1990	Donald M. Stewart / President	256,825
Columbia University / 1991	Eric Allen Rose / Surgeon/Professor	1,157,154
	Michael I. Sovern / President	449,547
Cornell University / 1991	Wayne Isom / Surgeon/Professor	1,779,721
	Frank H. T. Rhodes / President	308,603
Curtis Institute of Music /1990	**Gary Graffman / Artistic Director**	**153,500**
Dartmouth College / 1990	James O. Freedman Jr. / President	288,910
Dickinson College / 1991	A. Lee Fritschler / President	128,100
Drexel University / 1991	**Dennis G. Brown / Provost**	**154,773**
	Richard W. Schneider / Senior V.P. Administration	**152,723**
Duke University /1990	Ralph Snyderman / Dean, Medical School	439,049
	H. Keith Brodie / President	326,502
Duquesne University / 1991	John E. Murray Jr. / President	189,096
Educational Testing Service / 1991	David J. Brodsky / Executive Vice President	294,739
Emory University / 1991	James T. Laney / President	257,692
Episcopal Academy / 1990	**James L. Crawford Jr. / Headmaster**	**94,462**
Franklin & Marshall College / 1991	Richard Kneedler / President	159,660
Friends Central School /1990	**David M. Felsen / Headmaster**	**97,050**
Friends Select School / 1990	**Richard L. Mandel / Headmaster**	**99,509**
Georgetown University / 1990	Robert B. Wallace / Chairman, Surgery	725,474
	Rev. Leo J. O'Donovan / President	183,333
Gettysburg College / 1991	Gordon Haaland / President	149,399
Harvard Management Co. / 1991	Dave Mittelman / Vice President	738,604
	Jack Meyer / President	584,104
Harvard University / 1991	Daniel Tosteson / Dean, Medical School	294,070
	John McArthur / Dean, Business School	226,851
Haverford College /1990	**Tom Kessinger / President**	**162,560**
Haverford School / 1990	**W. Boulton Dixon / Headmaster**	**145,836**
Howard University / 1991	Franklyn G. Jenifer / President	158,543
Johns Hopkins University / 1991	William C. Richardson / President	324,899
Lafayette College /1990	David W. Ellis / President	197,685
LaSalle University / 1990	**F. Patrick Ellis / President**	**131,180**
Lawrenceville School / 1990	Josiah Bunting III / Headmaster	125,000
Lehigh University /1990	Peter W. Likins / President	231,350
Mass. Inst. of Technology (MIT) / 1991	Charles M. Vest / President	304,311
Moore College of Art /1989	**Edward McGuire / President**	**138,882**
Mt. Holyoke College / 1991	Elizabeth T. Kennan / President	209,752
National Merit Scholarship Corp. / 1990	M. Elizabeth Jacka / President	149,158
Neumann College / 1990	**Nan B. Hechenberger / President**	**147,212**
New York University / 1991	John Brademas / President	436,610
	L. Jay Oliva / President-elect and Chancellor	379,843
Northwestern University /1991	Arnold R. Weber / President	284,709
Notre Dame University / 1991	Rev. Edward A. Malloy / President	196,396
Peddie School /1990	Thomas DeGray / Headmaster	93,500
Pennsylvania Assn. of Colleges & University / 1990	Francis Michelini / President	101,750
Philadelphia College of Pharmacy /1990	**Allen Misher / President**	**163,719**
Princeton University / 1990	Harold T. Shapiro / President	273,814
	T. Dennis Sullivan / Pres., Princeton U. Invest. Co.	211,421
Radcliffe College / 1991	Linda S. Wilson / President	143,386
Rider College / 1990	Frank N. Elliott / President	256,646
Rochester Inst. of Technology / 1991	M. Richard Rose / President	197,568
Rockefeller University / 1990	Joshua Lederberg / President	226,350
Seton Hall University /1990	P.J. Carlesimo / Basketball Coach	243,711
	Ronald Riccio / Dean, Law School	145,867
Smith College / 1991	Mary Maples Dunn / President	160,625
Stanford University /1990	Donald Kennedy / President	294,782
St. Joseph's University / 1990	**Rev. Nicholas Rashford / President**	**115,500**
Swarthmore College / 1992	**Alfred Bloom / President**	**159,791**
Syracuse University / 1990	Richard F. MacPherson / Football Coach	273,431
	Melvin A. Eggers / Chancellor	241,167
Temple University / 1991	**V.P. Addonizio / Surgeon**	**627,080**
	L.S. Mahmud / V.P., Health Science Center	**443,752**
	R. L. Reinstein / Vice President	**222,986**

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Tufts College / 1991	Jean Mayer / President	257,451
UCLA / 1992	Charles Young / Chancellor	316,551
University of Chicago / 1991	Samuel Hellman / V P , Medical Center	571,909
	P Wanen Heeman / V P , Development, Alumni Rel	301,034
	Hanna H. Gray / President	283,000
University of Delaware /1990	E. Arthur Trahant / President	125,046
University of Louisville Athletic Assn /1990	Denny Crum / Basketball Coach	397,075
	Howard Schnellenberger / Football Coach	347,834
University of Miami /1990	Edward T Foote / President	285,700
University of Pennsylvania / 1991	**Alan J. Wein / Professor of Urology**	**860,000**
	William Norwood / Professor of Surgery	**701,577**
	Luis Schut / Professor of Neurosurgery	**656,825**
	William N. Kelley / Executive Director-Medical Center	**453,089**
	Sheldon Hackney / President	**313,661**
University of Pittsburgh / 1991	Michael Gottfried* / Football Coach	449,621
	Wesley W Posvar / President	423,679
University of Rochester / 1991	George D O Brien / President	242,000
University of Southern California / 1991	Cornelius Pings / Provost	243,369
University of the Arts /1990	**Peter Solmssen / President**	**203,750**
Ursinus College /1990	**Richard Richter / President**	**87,499**
Vanderbilt University / 1991	R. Bruce Shack / Plastic Surgeon/Professor	537,607
	Joe B Wyatt / Chancellor	396,623
Vassar College / 1990	Frances D. Ferguson / President	161,638
Villanova University / 1990	**Steven P. Frankino / Dean, Law School**	**164,139**
	Rollie V. Massimino / Basketball Coach	**148,244**
Washington University /1990	Ronald G. Evens / Vice Chancellor	331,346
Wesleyan University / 1991	William Chace / President	193,996
Widener University /1990	**Robert J. Bruce / President**	**151,800**
	Anthony Santoro / Dean, Law School	**139,700**
Williams College / 1991	Francis Oakley / President	201,600
Yeshiva University / 1991	David Zysman / Vice President for Development	304,500

• EDUCATION •

Peter J. Liacouras
President
Temple University
$407,059

• CULTURAL •

Mstislav Rostropovich
Music Director
Kennedy Center for Performing Arts
$483,500

• CULTURAL •

Joan Ganz Cooney
Chairperson
Children's Television Workshop
$546,686

• CULTURAL •

Frederick Breitenfeld Jr.
President
WHYY-TV/WHYY-FM
$176,804

CULTURAL

NONPROFIT ORGANIZATION / YEAR	NAME / TITLE	TOTAL COMPENSATION
Academy of Natural Sciences / 1991	**Keith S. Thomson / President**	**$162,530**
American Museum of Natural History / 1990	George D Langdon Jr. / President	215,490
American Theater Arts for Youth /1990	**Laurie Wagman / President**	**178,000**
Boston Symphony Orchestra / 1990	Daniel R. Gustin / Asst. Managing Director	151,600
Children's Television Workshop / 1992	David V B Britt / President	351,763
Colonial Williamsburg Foundation / 1990	Charles R. Longsworth / President	269,282
Educational Broadcast Corp. (WNET-TV) / 1990	Lester M. Crystal / Executive Producer	402,188
	William F Baker / President	265,663
	Robert Lipsyte / Host	235,050
Family Communications Inc. / 1991	Fred M "Mr " Rogers / President	136,218
Field Museum of Natural History / 1991	Willard L. Boyd / President	223,022
Franklin Institute / 1991	**Eric R. Aird / Executive Vice President cal**	**115,000**
Joffrey Ballet /1990	Gerald Arpino / Artistic Director	130,967
Longwood Gardens Inc. / 1990	**Frederick E. Roberts / Director**	**92,648**
Metropolitan Museum of Art / 1991	Philippe De Montebello / Director	214,766
	William H Luers / President	193,779
Museum of Fine Arts /1990	Alan Shestack / Director	171,125
National Gallery of Art /1990	J. Carter Brown / Director	249,272
	E. Roger Mandle / Deputy Director	178,662
National Geographic Society /1991	William Graves / Editor	252,963
National Public Radio /1992	Robert Edwards / Senior Host	134,141
	Douglas J. Bennet / President	158,550
New York City Ballet / 1991	Arnold Goldberg / Orchestra Manager	113,000
New York City Opera / 1991	Christopher Keene / General Director	214,000
Pennsylvania Horticultural Society / 1992	**Jane G. Pepper / President**	**92,000**
Philadelphia Museum of Art / 1992	**Robert Montgomery Scott / President**	**153,614**
	Anne d'Harnoncourt / Director	**148,582**
Philadelphia Orchestra / 1992	**Joseph Kluger / President**	**205,096**
	Norman Carol / Concertmaster	**156,102**
	Richard Woodhams / Principal Oboe	**142,661**
Public Broadcasting Service / 1991	Bruce Christensen / President	171,051
WGBH-TV Educational Foundation / 1991	Norman Abram / Talent,"The New Yankee Workshop"	173,000
	Henry P. Becton / President	165,146
WHYY-TV/WHYY-FM / 1991	**Robert C. Prindible / Vice President, Finance**	**99,173**
	David Othmer / V.P. and TV/Radio Station Manager	**97,971**
Winterthur Museum / 1991	Thomas A Graves Jr / Director	177,591

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Pay Packages of Nonprofit Executives

As reported on IRS tax forms. Boldface denotes local nonprofits.

HEALTH CARE

NONPROFIT ORGANIZATION / YEAR	NAME / TITLE	TOTAL COMPENSATION
Abington Memorial Hospital / 1992	Thomas Dent / Chief of Surgery	400,691
	David Eskin / Chief of Staff	326,964
	Felix M. Pilla / President	309,984
Albert Einstein Healthcare Foundation / 1991	John Murino / Senior Vice President	251,625
	Robert Kimmel / Vice President - Marketing	188,835
Albert Einstein Med. Center (Philadelphia) / 1991	Mary Ann Keenan / Chairperson	431,553
	Robert Somers / Chairman	341,852
American Board of Internal Medicine / 1991	John A. Benson / President Emeritus	274,397
American College of Physicians / 1991	John R. Ball / Executive Vice President	292,380
	Frank Davidoff / Assoc. Executive Vice President	204,186
American Hospital Assn / 1990	Carol McCarthy / President	342,204
	David Woodrum / Executive Vice President	257,043
Archway Programs / 1990	James I. Mason / Executive Director	178,030
Blue Cross/Blue Shield Assn. / 1990	Bernard R. Tresnowski* / President	548,170
	Douglas Peters / Senior Vice President	231,750
Brandywyne Hospital / 1990	James J. Burnham / President	140,500
Brigham Surgical Group Foundation / 1992	John J. Collins / Teaching Surgeon	491,514
	Lawrence Cohn / Teaching Surgeon	659,576
Brigham & Women's Hospital / 1991	H. Richard Nesson / President	872,628
Bryn Mawr Hospital / 1991	Darrell J. Bell / President	197,018
Bryn Mawr Rehab Hospital / 1990	Ken Hanover / President	165,444
Chester County Hospital / 1990	H.L. Perry Pepper / President	171,995
Chestnut Hill Hospital / 1990	Cary F. Leptuck / President	245,428
Children's Hospital of Philadelphia / 1991	Louis G. Troilo / Assistant Treasurer	156,500
Children's Hospital of Pittsburgh / 1991	Edwin K. Zechman Jr. / President	324,949
Children's Hospital/National Med. Center / 1991	Donald Brown / President	337,110
Children's Seashore House / 1991	Richard Shepherd / President	132,361
City of Hope National Med. Center / 1991	Sanford M. Shapero / President	318,105
Cleveland Clinic Foundation / 1990	Floyd D. Loop / Executive Vice President	955,602
	Delos Cosgrove III / Surgeon	775,661
Cleveland Clinic - Florida / 1989	Carl C. Gill / Chief Executive Officer	596,000
Comm. Home Health Services (Philadelphia) / 1990	Adele Hobb / President	103,517
Cooper Hospital/University Med. Center / 1992	Anthony Delrossi / Surgeon/Professor	803,870
	Kevin Halpern / President	290,413
	Albert Tama / Executive Vice President	283,020
Coriell Institute / 1990	Gerard J. McGarrity / President	130,770
Crozer Chester Med. Center / 1992	Harvey Spector / Director of Pathology	211,836
	Gerald Miller / President	179,113
Crozer-Keystone Health Sys. / 1991	John C. McMeekin / President	258,000
	Richard Thomas / Executive Vice President	216,340

• HEALTH CARE •

Robert Young
President
FOX CHASE CANCER CENTER
$368,823

• HEALTH CARE •

Martin Goldsmith
President
ALBERT EINSTEIN HEALTHCARE FOUNDATION
$383,416

• HEALTH CARE •

Elizabeth Avery
President
LANKENAU HOSPITAL
$188,907

• HEALTH CARE •

Plato A. Marinakos
Executive Vice President
MERCY CATHOLIC MEDICAL CENTER
$439,134

Deborah Heart & Lung Center / 1990	Lynn McGrath / Surgeon	585,769
	Vladir Maranhao / Surgeon	411,346
Delaware Val. Hospital Council / 1991	John E. Flood / President	142,408
	Loreta M. McLaughlin / Executive Vice President	114,670
Doylestown Hospital / 1990	Richard A. Reil / President	138,188
Emergency Care Research Inst. / 1990	Joel Nobel / President	135,689
Empire Blue Cross/Blue Shield / 1990	Albert A. Cardone / Chief Executive Officer	540,000
Episcopal Hospital / 1990	Stanley W. Elwell / President	140,000
	F.J. McKay / Executive Vice President	236,665
Franciscan Health System / 1990	Ronald R. Aldrich / President	289,923
	Richard A. Long / President - FH Group East	247,346
Frankford Hospital / 1990	John B. Nell / President	222,222
Friends Hospital / 1990	James Delaplane / Director	154,986
Geisinger Clinic / 1991	William J. Krywicki / Associate - Orthopaedics	663,899
	Stuart Heydt / Director	247,025

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Germantown Medical Center /1990	Hugh J. Maher / President	234,948
Graduate Health System / 1991	Robert Mathews / Treasurer	289,385
	Robert Galloway / Senior Vice President	185,545
Graduate Hospital / 1991	Charles C. Wolfreth Jr. / Chairman of Surgery	200,000
Grand View Hospital /1990	Stuart H. Fine / Chief Executive Officer	115,000
Group Health Inc /1990	Frank Branchun / President	239,560
Hahnemann University / 1991	M. Kerstein / Chairman of Surgery	385,642
	Harry Wollman / Senior Vice President	354,180
	Scott K. Phillips / Senior Vice President	333,054
Harvard Community Health Plan /1990	Thomas O Pyle / President	288,478
Health Insurance Assn of Amer /1990	Linda Jenckes / Vice President	245,927
HealthEast Inc / 1990	David Buchmueller / President	257,308
Holy Redeemer Health System / 1990	Judith K. Call / President	141,381
Hospital Association of Penn. / 1991	Douglas R Spurlock / Executive Vice President	329,657
	John A. Russell / President	222,600
Hospital for Special Surgery / 1991	Andrew Weiland / Medical Director	848,140
Howard Hughes Medical Institute / 1990	Graham O Harrison / Chief Investment Officer	498,391
	Purnell W Choppin / President	455,100
Ieones Health System / 1991	Susan M. Hansen / President	126,145
JFK Hospital (Philadelphia) /1990	Paul Scholfield / Chief Executive Officer	130,399
Joint Comm Accred. Healthcare Org. / 1991	Dennis S O'Leary / President	388,191
Kaiser Hospitals /1989	James A Vohs / Chairman	511,511
Kendal Corp. / 1991	Lloyd W. Lewis / Executive Director	150,206
Lower Bucks Hospital /1990	Jose Samson / Physician	119,694
Lutheran Gen Health Care System / 1991	Stephen L Urmniel / President	508,941
Magee Hospital / 1990	William E. Staas Jr. / President	150,040
Massachusetts General Hospital / 1991	J Robert Buchanan / Chief Executive	561,868
Mayo Foundation for Med Educ. & Research / 1989	W Eugene Mayberry / Chairman-Development	349,457
Mayo Foundation / 1991	G K Danielson / Surgeon	426,507
	M B Farnell / Trustee	272,647
Medical College of Penn. / 1991	Howard Zaren / Chief of Surgery	936,982
	Henry N. Sherk / Chief Orthopaedic Surgery	460,750
	Paschal M. Spagna / Chief Cardiothoracic Surgery	377,514
Mercy Health Plan / 1991	Felicia Neczypor / President	199,587
Montefiore University Hospital / 1990	Philip Troen * / Physician-In-Chief	646,367
	Irwin Goldberg * / President Emeritus	909,553
Montgomery Hospital /1990	John P. Cossa / Director of Medicine	221,292
	Harry W. Gehman / Director	148,683
Moss Rehabiliation Hospital /1990	Randall Braddom / Vice President	249,423
	Sy Schlossman / President	174,582
Mt. Sinai Hospital (NY) /1990	Barry Freedman / Director	523,067
Mt. Sinai Hospital (Philadelphia) / 1991	Francis Bonner / Physician	211,540
National Bd. of Med. Examiners /1990	Robert L. Volle / President	194,775
Nemours Foundation /1990	John Noseworthy / Surgeon-In-Chief	257,027
New England Medical Center / 1991	Jerome Grossman / Chief Executive	547,075
North Penn Hospital /1990	Robert H McKay / President	135,556
Northeastern Hospital /1990	R. Moylan / Chief Executive Officer	98,033
Northeastern Hospital Foundation / 1991	Francis X. Meehan / Chairman	111,267
Osteopathic Hospital (Philadelphia) /1990	J.H. Blackman / Chief Operating Officer	139,113
Our Lady of Lourdes Med. Center /1989	John Capelli / Vice President, Medical Affairs	110,923
	Alexander J. Hatala / Executive Vice President	118,438
Paoli Memorial Hospital / 1991	Leland I. White / President	200,309
Pennsylvania College of Podiatric Medicine / 1991	James E. Bates / President	172,069
Pennsylvania Hospital / 1991	H. Robert Cathcart / President	200,000
	Jame B. Hoyme / Medical Director	161,793
Pennsylvania Medical Society / 1990	Robert W. McDermott / Medical Director	116,226
Philadelphia Heart Institute /1990	Ami Iskandrian / Employee	143,375
Philadelphia College of Osteopathic Med. / 1990	Daniel L. Wisely / Dean	184,475
Phoenixville Hospital / 1990	Richard E. Seagrave / President	98,244
Pottstown Memorial Med. Center / 1990	Marvin I. Silverman / Director of Emergency Room	174,627
	Larry A. Crowell / President	123,692
Presbyterian Med. Center of Philadelphia / 1991	I. Donald Snook Jr. / President	174,196
Rosborough Memorial Hospital /1990	Marvin Mashner / President	119,000
Sacred Heart Hospital (Norristown) /1990	Navin P. Shah / House Staff Physician	136,790
Sacred Heart Med. Center (Chester) /1990	Glenn Hirsch / President	149,892
Salk Institute / 1991	Renato Dulbecco / President	244,796
Santa Barbara Medical Foundation Clinic / 1991	Arthur S. Greditzer / President	188,619
Southern Chester Cty. Med. Center /1990	Larry K. Spaid / President	139,930
St. Agnes Med. Center / 1990	Robert C. Fleming / Executive Vice President	120,634
St. Clare's-Riverside Med. Center /1990	Joseph Trunfio / Senior Vice President	170,862
St Jude Children's Research Hospital /1990	Joseph V Simone / Director	203,344
Suburban General Hospital / 1990	Edward R. Solvibile / President	127,659
Taylor Hospital /1989	W.M. Tomlinson / President	176,155
Texas Heart Institute / 1990	James Cuthbertson / President	189,257
Thomas Jefferson University / 1991	Joseph S. Connella / Senior Vice President	363,796
	Robert A. Peterson / Senior Vice President	292,360
	Thomas J. Lewis III / Senior Vice President	219,583
United Hospitals Inc /1990	Myles G Turtz / Chief Executive Officer	319,581
	Anthony Gigliotti / President	276,290
University Cardiovascular Foundation / 1990	Harvey L. Waxman / Medical/Consultant	247,053
University Hospitals of Cleveland /1990	James A Block / President	273,599
University of Maryland Med. System Corp / 1991	Morton I. Rapoport / President	357,589
Univ. of Med. & Dent.-N.J. Foundation / 1990	James W. Aylward / President	128,276
Warminster General Hospital /1990	Frank Fumai / Executive Director	156,182
West Jersey Health System /1990	Barry D. Brown / President	257,181
Whitehead Inst. for Biomed. Res. /1990	David Baltimore / President	314,394
Wills Eye Hospital / 1990	D. McWilliams Kessler / Executive Director	128,081

(1) Includes income from Pew Charitable Trusts and Glenmede Trust Co

* Compensation includes severance or lump-sum retirement benefit.

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PRODUCTION

Warehouses of Wealth: The Tax-Free Economy

Sixth in a series.

Tax-exempt bonds have fueled a construction boom. Taxpayers underwrite the loans. The purpose was to meet society's needs. Some are stretching the definition of those needs.

For nonprofits only: A cheap pool of money

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS
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This is a lesson in how to buy and sell nursing homes and make millions of dollars in profits while using someone else's money.

First, negotiate a deal with a financially troubled company to buy a chain of nursing homes.

Next quickly arrange to sell the nursing homes to a nonprofit organization set up by a business associate. It's OK if the nonprofit doesn't have any money or assets and has been inactive for a year or two.

Before you sell, raise the price by $6.5 million; that's your gross profit.

As part of the deal, negotiate contracts to manage the nursing homes, to make renovations and to collect patient bills — contracts potentially worth up to $5 million.

Now the critical part. To pull all this off, you'll need more than $80 million.

That's where the taxpayers come in.

Thanks to Congress, there's a vast pool of cheap money available if you're a nonprofit organization. It's called tax-exempt bonds.

All you have to do is convince a public authority to issue tax-exempt bonds for the nonprofit buyers to finance the purchase. And your associates get to serve as underwriters in the bond sale, earning $8 million in fees.

Sound too good to be true?

It's true.

Bruce Hayne Whitehead, a former Texas bank examiner turned mergers-and-acquisition specialist, and associates arranged such a deal in 1989. They got $86 million to finance a two-step transaction in which they bought and sold 45 Iowa nursing homes.

Fueling Whitehead's deal was one of the fastest-growing methods of financing in the nation: tax-exempt bonds.

Hospitals, nursing homes, colleges and other nonprofit organizations can tap into this seemingly endless stream of cash.

Say a nonprofit sells low-interest bonds through a public authority. The cost of borrowing millions of dollars might be only 7 percent a year for decades, compared with a commercial rate of 10 percent.

The lower interest rates are meant to enable charitable organizations to fund worthy projects. And investors get a break by not having to pay taxes on the interest income they earn on these bonds.

Taxpayers, of course, subsidize all this.

This low-interest financing is merely one of the tax breaks that have boosted the tremendous growth of nonprofit organizations in the last two decades.

As The Inquirer has reported this week, the tax-free nonprofit economy has grown four times as fast as the rest of the economy since 1970. Nonprofits now control property, cash and investments worth more than $850 billion.

The cost in lost taxes is well over $36 billion a year. Tax-exempt bonds are a key

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Nonprofits' favorite financing: Bonds

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part of that tax-free economy.

The U.S. Treasury estimates that about $2 billion is lost each year in federal taxes on interest income from these bonds.

This method of taxpayer-subsidized financing was made available to charities and other nonprofit organizations by Congress so they could build hospitals and colleges or fill other socially beneficial needs.

In practice, though, tax-exempt bonds often are used for less high-minded purposes — such as buying and selling real estate, financing mergers, building exclusive retirement communities, and taking tax-paying businesses off the tax rolls.

Which gets back to Bruce Hayne Whitehead and his $86 million nursing home deal.

The fallout from that transaction is still being felt across 40 Iowa communities.

In towns like Creston, in sparsely populated Union County, the sale resulted in a bitter lawsuit over the payment of property taxes by the local nursing home, Creston Manor.

In 1990, the new owners, Mercy Health Initiatives, asked county officials to exempt the nursing home from paying $30,000 a year in property taxes. The reason: They were a nonprofit organization.

County Tax Assessor A.D. Paxton balked.

"To my knowledge, they weren't doing anything different up there than before, when they were owned by Beverly Enterprises," the for-profit firm that sold the nursing home, Paxton said in an interview.

A county tax board upheld Paxton's ruling. The nonprofit, which by then had changed its name to Care Initiatives, filed suit.

In September 1991, after a week-long trial, Iowa District Judge Gene L. Needles issued a stinging 21-page decision in favor of the tax board and Paxton.

"Care Initiatives is a 'shell' nonprofit corporation used by Bruce H. Whitehead and the bond underwriters to obtain financing necessary to enable them to make millions of dollars of excessive profits," Needles wrote.

"Care Initiatives serves no legitimate purpose and was used primarily to obtain tax-exempt financing, shield the parties using the facilities from liabilities and obligations as owners, and to evade the payment of property taxes," Needles went on. "The property is not being used by a charitable institution or organization."

Whitehead declined to be interviewed. In a brief telephone conversation, he said he had "taken substantial financial risks" in the Iowa transaction and had earned his profits.

In a deposition, he said he had put more than $1 million of his own money into the deal.

Attorneys for Care Initiatives have appealed Judge Needles' decision to the Iowa Supreme Court, where the case is pending. The nonprofit lost a similar case in another Iowa county.

"I think these guys thought they could come up here from Texas and roll all over us hicks from Iowa," Paxton said.

Since the judge's ruling, tax assessors in other Iowa counties are poised to revoke the tax exemptions of Care Initiatives' 38 other homes, Paxton said.

"If the Supreme Court upholds our case, you can expect the others to follow suit."

■

Each day, hundreds of quasi-public agencies and state governments issue tax-exempt bond offerings for nonprofit groups.

These authorities don't actually borrow the money. They merely serve as conduits for the real borrower — the hospital, college or nonprofit institution that runs the project once it is built and is responsible for paying back the debt.

Instead of turning to private money markets, where they would have to pay higher commercial interest rates on the money they borrow, nonprofit groups are able to turn to their own private market for raising capital.

The lower financing costs can result in savings of millions of dollars in interest.

It is a growing business, this market for taxpayer-subsidized bonds. Throughout America, in communities so small they don't have a town hall to cities the size of Philadelphia, tax-exempt bonds have become one of the most favored forms of financing.

In 1980, the volume of tax-exempt bonds sold by nonprofit organizations was more than $6 billion. In 1992, it was almost $64 billion.

Between 1980 and 1992, the value of bonds issued for nonprofits grew an average 21 percent a year — compared with 13 percent for other types of bonds issued by public authorities, such as those to finance water and sewer systems.

There are several reasons for the rapid growth. One is that nonprofit organizations, just like homeowners in the last few years, refinanced existing bonds to cash in on lower interest rates.

Another is that, over time, many bond authorities came to view their role as an economic development agency, not as a protector of the public purse deciding whether a project deserved taxpayer-subsidized money.

If the numbers added up, and a proposal wasn't especially risky, the authority pushed it through, rarely questioning whether it was really needed.

In May 1992, for instance, the Hospitals Authority of Philadelphia boasted in a letter about being named the number one issuer of tax-exempt bonds.

"A first for Philadelphia," the letter began. "I wish to share with you a significant community accomplishment. ... We have just learned that the Philadelphia Hospitals Authority has been ranked the number one health care issuer in the United States. The figure of $360 million invested by private investors shows considerable confidence in Philadelphia."

"Our city is a major health-care center and we are growing," authority president Donald A. Cramp wrote. "Philadelphia has seen more health-care financing activity than many large states — combined!"

Cramp's enthusiasm notwithstanding, the taxpayers of Philadelphia pay a price for all this development. The city is consistently ranked among the most expensive in the nation for hospital and health services. A growing portion of patient bills goes to pay for the debt on all this new construction. And more tax-exempt property falls off the city tax rolls.

"Authorities play the role both of lenders and as economic developers," said John Van Gorkom, president of the National Council of Health Finance Authorities. "We clearly are economic developers."

Still another explanation for the growth is the number of authorities.

In about half the states, a single agency or authority acts as the conduit for bonds. In other states, there are dozens of authorities.

In New Jersey, tax-exempt bonds are issued either by the Economic Development Authority or the New Jersey Health Care Facilities Finance Authority.

By contrast, Pennsylvania has 103 authorities that issue bonds only on behalf of hospitals, colleges and nursing homes.

That does not include — nor does this story focus on — another 2,137 municipal and county authorities in Pennsylvania that issue bonds for other public purposes, such as parking garages and sewers.

For tax-exempt bonds for nonprofit organizations, Pennsylvania has an average of nearly two authorities per county.

Why so many? One explanation is politics.

In Pennsylvania, distributing lucrative bond underwriting work to favored law firms, investment bankers, financial advisers and other consultants has long been a part of county politics. Those who get the work often contribute to political campaigns.

Some Pennsylvania bonding authorities are so small they don't even have offices. When a bond issue is needed, politicians call up an underwriter and lawyers; the process essentially takes place by mail.

Others are known as "captive authorities," created by the nonprofit organization selling the bonds, housed in an office of the nonprofit and existing only to sell its bonds.

Often authorities compete to sell bonds. And it is not unusual for a nonprofit that gets rejected by one authority to turn to another authority to issue its bonds.

In Pennsylvania, the Department of Community Affairs is responsible for tracking activities of authorities. But officials concede that they have little control over these many authorities, let alone regulate them.

Oversight is so loose that many authorities don't bother to send copies of their annual report and audited financial statement to Harrisburg, as required by law.

"Largely speaking, they're pretty much on their own," said Robert B. Evans, municipal consultant in the Pennsylvania Department of Community Affairs.

"No state agency in any sense is really controlling the authorities. They establish their own rules, their own rates," Evans said.

Local control comes at a

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price. Bond defaults are much more likely to involve bonds issued by smaller authorities than those issued by states with single authorities, industry data show.

In 1992, the number of defaults associated with local authorities was 20 times greater than defaults associated with state authorities, according to data from the Bond Investors Association.

There were 18 bond defaults, with a value of $255 million, that had been issued by state authorities. There were 360, for more than $2 billion, issued by local authorities. Investors, of course, got stuck.

"I think the numbers speak for themselves," Van Gorkom said. "I can't speculate. But I will say I think you need an active staff and authority, and on the local level that's not always the case."

Richard Lehmann, president of the Bond Investors Association, which tracks bond defaults, puts it more bluntly.

"The reason for the difference in the default rates is quite simply that the larger authorities at the state or city level have a greater level of expertise and due diligence than smaller, local authorities that may issue bonds only once a year, or less than that.

"There's also more influence at the local level," he said. "Quite frankly, it's kind of an old buddy network, where the local authority issuing the bonds is made up of all local residents who know little or nothing about bonds, but know a lot more about pleasing their old buddies."

Many of the defaulted bonds were unrated by credit agencies, such as Moody's and Standard & Poor's.

Many of the defaults have involved nursing home and retirement centers. Between 1980 and 1992, a total of 280 such bonds ended in default, worth more than $2 billion, the Bond Investors Association said.

Even in cases where the IRS suspects abuses, there is little it can do. The IRS could rescind the tax break investors get. But that would "only punish the innocent party in the transaction," said Marcus S. Owens, director of the IRS's Exempt Organizations Technical Division, which oversees nonprofits.

It would not penalize the nonprofit, underwriters or consultants who sold the bonds.

"There is no intermediate sanction. It would be useful to have a penalty or sanction that would address the problem," he said.

Only Congress can grant such a penalty, and it has not. In the meantime, IRS attorneys are negotiating more and more voluntary agreements with organizations when it believes there have been violations. And it is informing newly formed nonprofits that they may not use tax-exempt financing without prior approval from the service.

Owens said the IRS had 27 audits under way that involve the use of tax-exempt bonds. Many of these cases came to the government's attention through public complaints, he said.

Of course, officials where the nonprofits are located have an alternative. If the bond deal involves a change of ownership, such as in the Iowa case, they can challenge or revoke the exemption for property taxes. It does not happen very often. When it does, sparks usually fly.

■

The tale of Care Initiatives begins with Bruce Whitehead, a Dallas financier who once offered to settle a dispute with the chairman of the Arkansas Finance Authority in the alley outside a meeting hall.

Asked to describe his business activities in a 1991 deposition, Whitehead responded that at one time or another, he had been involved in the banking business, construction, furniture and auto parts stores, a machine shop, an insurance agency, oil and gas, real estate, a fast-food franchise, apartments, retirement housing, an airplane charter company and a firm for brokering and selling planes.

"My principal day-to-day activity is working on mergers and acquisitions and financing," Whitehead testified at the Iowa trial.

A 1973 graduate of the University of Texas with a degree in finance and accounting, Whitehead started his career as a credit analyst with the Continental Bank in Houston, and shortly thereafter went to work for the Texas Banking Department as an assistant examiner. By the time he left in the late 1970s, he was senior examiner in charge of 35 banks in central Texas.

In 1984, Whitehead bought a bank in Amarillo and merged it with another local bank. That year, he also formed The Britwill Co., a management firm, and entered the nursing home business.

He developed three nursing homes, which he later sold to a nonprofit corporation, Heartway III. The sale was financed with tax-exempt bonds.

One of the people involved in the Heartway III transaction was Terry Colip, an investment banker with whom Whitehead had done business since the mid-1980s. It was Colip, Whitehead later testified in the Iowa case, who first steered the Iowa deal his way.

According to Whitehead's deposition, Colip was approached by a Dallas broker looking to arrange a sale of nursing homes owned by the debt-laden Beverly Enterprises Corp., the largest for-profit nursing-home chain in the nation.

Colip, in turn, suggested that the broker take the package to Whitehead, "that he thought I'd be a good person to work on it," Whitehead testified.

The original package called for Whitehead to buy facilities in Nebraska, South Dakota, Arkansas and Iowa. He wasn't interested in South Dakota and ran into problems in Arkansas, where a bond deal he thought he had negotiated collapsed after unfavorable publicity.

In Arkansas, the plan was for Whitehead to buy the nursing homes from Beverly and sell them to a tax-exempt organization — a nonprofit set up especially for the deal. After local politicians questioned the sale, the state authority turned down the Whitehead group.

"And at the time that you were turned down, did you tell the chairman of the Arkansas Finance Authority that you would like to go out in the alley and settle it with him?" Whitehead was asked at the 1991 trial before Judge Needles in Iowa.

"Yes sir, I sure did," Whitehead responded.

No fistfight took place. Whitehead continued to negotiate in Iowa, where the reception was friendlier.

In August 1989, Whitehead's company, Ventana Investments, bought 45 nursing homes from Beverly Enterprises for $57 million, a figure that included a $10 million profit for the nursing home chain.

At the same time, Ventana sold 41 of the nursing homes to the nonprofit Mercy Health Initiatives — later renamed Care Initiatives — for $63.5 million, leaving Whitehead a gross profit of $6.5 million.

Thus, in the span of about 24 hours, two separate corporations made a total profit of $16.5 million on the sale of 45 nursing homes that one financial analyst described at the time as a "fire sale."

Financing for the two-step sale was arranged through the Iowa Finance Authority, which issued $86 million in tax-exempt bonds on behalf of Mercy Health Initiatives.

The amount of bonds was sharply higher than the sale price for the nursing homes because it included about $20 million in underwriters' fees and other charges.

The underwriters were Terry Colip, Whitehead's old business associate, and Richard Young of the now defunct investment banking firm, Underwood Neuhaus. They were paid more than $8.5 million — or 9 percent of the offering.

Colip, his brother Gregory, and Young also were the incorporators of Mercy Health Initiatives, a Texas nonprofit that had been inactive since it was formed in 1988. They served as directors until shortly before the bond offering, court records and incorporation papers show.

Of the dual role played by Terry Colip and Richard Young, Judge Needles later wrote: "During this negotiation period, [Mercy Health Initiative's] board of directors consisted of the two bond underwriters, Terry Colip and Richard Young, who made millions of dollars from the transaction, and Terry Colip's brother, Greg Colip."

Whitehead testified that Mercy Health Initiatives and its successor, Care Initiatives, were operated independently by their respective boards of directors. Whitehead and his firms had no control over either, he said.

Needles offered a different view. "Bruce H. Whitehead, Ventana Investments and The Britwill Co. [Whitehead's nursing home management firm] exercised significant influence and control over Care Initiatives at the time of the acquisition . . ." he wrote.

"Mr. Whitehead and The Britwill Co. cor-

Continued on next page

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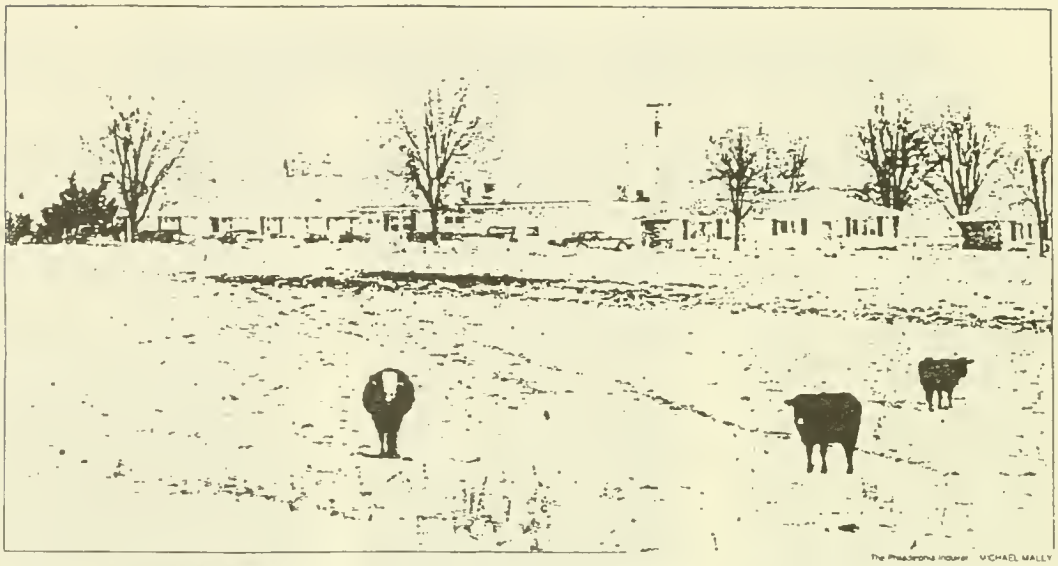
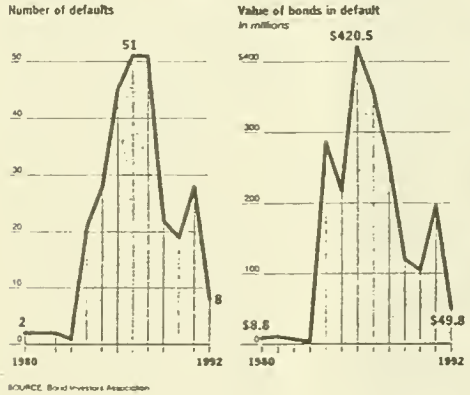


The new owners of Creston Manor Nursing Home in Iowa asked Union County to exempt the home from $30,000 a year in property taxes. Why? Because it was nonprofit. The county said no, and the case ended up in court. The judge ruled for the county, saying, "The property is not being used by a charitable institution or organization."

Defaults on Tax-exempt Bonds for Retirement and Nursing Homes



SOURCE: Bond Investors Association

A.D. Paxton, Union County tax assessor, rejected Creston Manor Nursing Home's application to be exempt from property taxes. "I think these guys thought they could come up here from Texas and roll all over us hicks from Iowa," he said.

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Continued from preceding page

tinue to exert influence and control over Care Initiatives and its ongoing operations.

Only Britwill can sign checks. No board member or officer has check-signing authority or has ever signed a check or paid a bill."

The Britwill Co. had negotiated a contract to run the Iowa nursing homes for Care Initiatives.

Before the closing of the two-step transaction, the Colip brothers and Richard Young resigned from Care Initiatives and a new board was named. Terry Colip and Young remained as underwriters to the bond deal.

At the time, Care Initiatives was little more than a shell. It had no assets, charitable contributions or sources of income. After the sale of the homes, its capitalization consisted entirely of debt — the $86 million bond issue.

Care Initiatives was one of several inactive Internal Revenue Code 501 (c) (3) corporations which Terry Colip, Richard Young, Bruce Whitehead and Ventana Investments had organized or otherwise had available and which they considered using as vehicles to obtain tax-exempt bond financing necessary to fund the acquisition transactions," Needles wrote.

Ted Chapler, who took over as executive director of the Iowa Finance Authority after the transaction, said the agency's directors discussed the various relationships in a telephone conference call and were satisfied there were no problems.

"The various attorneys involved also reviewed those and decided there was nothing contravening the law in those relationships," he said.

Chapler said the authority members viewed the bond offering as a "good deal for Iowans. There was a discussion at the time of what happens if it [the sale] doesn't go through. Homes will be closed and rural Iowans will be kicked out, and the economic base of those towns will be ruined," he recalled the members saying.

Chapler said authorities such as his had little choice but to issue tax-exempt bonds if the finances of the charitable organization appeared to be in order.

"I don't offer it as an excuse, but we were — and are — constrained by existing federal law. It does not grant us a lot of latitude. As long as they complied with all of the facets of the law allowing this type of activity, we had no basis not to issue the bonds.

"In essence we're hamstrung by the law," he said.

Paxton, the Union County tax assessor, wasn't feeling nearly as generous. When he reviewed the application of Care Initiatives for a property tax exemption for its Creston Manor, Paxton thought, "No way."

Paxton said he concluded that nothing had changed at Creston Manor except a desire to be free of property taxes of about $30,000 a year. "I rejected their application."

Attorneys for Care Initiatives appealed to a county board, which upheld the assessor's ruling. A lawsuit was then filed, leading to the July 1991 trial.

In the weeklong session, Whitehead testified that he had taken a substantial financial risk. Without tax-exempt financing, he questioned whether the sale could have taken place.

Judge Needles wrote that the bond offering had left Care Initiatives saddled with debt. He called the 9 percent underwriter fees "unreasonable and excessive."

Combined with Whitehead's gross profit of $6.5 million, "the two fees constitute approximately 18 percent of the debt financing," he wrote. "Such excessive costs are not normal or reasonable financing costs."

Attorneys for Care Initiatives dispute Needles' findings. In court papers appealing the decision, they said the relationship between Care Initiatives and Whitehead's companies "was at arm's length" and that the various fees were "fair and reasonable."

"[Needles] apparently believes that Bruce Whitehead engineered the sale of the Iowa facilities without any check against his own self-interest. The overwhelming weight of the evidence, however, shows that the transactions were carefully analyzed and thoroughly reviewed up front by all parties involved as well as their counsel," the attorneys wrote.

Last week, attorneys for Paxton and Care Initiatives made oral arguments before the state Supreme Court. A decision is pending.

■

In banking, there is an old saying that the only ones who can get loans are those who have money in the first place. At some bonding authorities, organizations that already have plenty of money often are the ones that get the breaks on tax-free bonds.

Take the New Jersey Economic Development Authority, a leading issuer of tax-exempt bonds.

In 1991, the authority, an independent entity established by the state, approved $354 million in tax-exempt bonds.

Nearly $85 million of that went to nonprofit organizations. They ranged from Seeing Eye Inc., the guide-dog trainer in Morris County, to the Institute of Management Accountants Inc. in Bergen County.

By far the largest nonprofit bond issue — one that accounted for almost one-third of the funding for nonprofits that year — was $25 million for the Lawrenceville School in Lawrence Township, Mercer County.

The private prep school wanted to add several buildings, including faculty housing, so it asked the state authority in July 1991 to approve $25 million in tax-exempt bonds. The cost of the projects was $30 million, of which 83 percent was financed through the bonds.

Lawrenceville is an exclusive school. Its tuition next fall will be $15,500, with another $3,400 for room and board, putting it well beyond the reach of most taxpayers. The school, grades eight through 12, has about 750 students. Its 130-acre campus includes a private, nine-hole golf course, which is off the property tax rolls.

According to its nonprofit tax filing, in the year ended June 30, 1990, Lawrenceville School had revenues of $27 million, with profit of $9.5 million. Its $78 million in securities and cash generated $5 million a year in dividends and interest.

Nevertheless, on its application to the Economic Development Authority, the school said that if it did not get tax-exempt financing, it would have to borrow money "on a higher taxable basis, which would lead to higher levels of tuition and a less competitive situation with respect to the schools that it competes with. There will also be less money available for financial aid, scholarships and other programs."

Part of the $25 million was used to build new faculty housing on campus. At the same time, the tax-exempt school was loaning money from its own funds to faculty members at favorable rates.

Teachers aren't able to buy their own homes and build up equity because they must live on campus, said James T. Adams, Lawrenceville's assistant headmaster. So the school has made about $1.8 million in loans to faculty members for "retirement homes," according to Lawrenceville's IRS return.

The 25-year mortgages, for up to $150,000, are made out of the school's endowment. The mortgages' interest rate is based on the rate of return the endowment earns.

Why did the New Jersey authority issue the bonds for Lawrenceville School?

It was a major construction project during a deep recession in the construction industry, said Rose M. Smith, public affairs director of the authority. She said that the tax code allows such issues for nonprofit organizations like the Lawrenceville School.

"There's no reason why the authority should not assist local nonprofit community organizations," Smith said.

According to the authority's annual report, its mission is "to retain and expand job opportunities, enlarge the tax base of the state and its local governments and encourage economic growth and diversity."

The Lawrenceville School project temporarily employed about 690 construction workers. New, permanent jobs created by the expansion will total four, the school's bond application said.

As for enlarging the tax base, Lawrenceville School now has property valued at $73 million on the books at the Lawrence Township Assessor's Office. About 98 percent of that is exempt from property taxes — as the new construction will be.

If tax-exempt Lawrenceville paid taxes on all its property, its real estate tax bill would be $1.6 million a year.

Two years ago, municipal assessor William H. Hough tried to tax several houses the school had bought for faculty members. "I didn't want to put them on the exempt property list," he said.

The school took its challenge to the Mercer County Board of Taxation and "that was the end of that," he said.

Hough said that because he has "been burned once," he won't try to collect property taxes on the faculty houses Lawrenceville has built on its campus with the bond money.

■

High on the list of projects borrowers have defaulted on are expensive retirement centers built with tax-exempt bonds.

A 1991 report by the General Accounting Office took note of dramatic growth in the use of tax-exempt bonds to finance retirement centers.

In 1980, authorities issued $52 million in tax-exempt bonds for retirement projects, the GAO reported to Congress. In 1989, $614 million in bonds were issued for such projects — nearly 12 times as much.

In all, nonprofit organizations sold nearly $3 billion worth of tax-exempt bonds during the 1980s to build retirement centers.

While other tax-exempt financing, such as industrial revenue bonds, had a default rate of about 1 percent, one of every five retirement centers built with tax-exempt bonds had defaulted, the GAO found.

The GAO attributed this 20 percent default rate to the excessive debt of the retirement centers.

Unlike hospitals or other nonprofits that used reserves and donations to help finance new projects, the retirement centers had little, if any, equity of their own. Thus the heavy debt loads.

The GAO report also found that the majority of the retirement centers built with tax-exempt financing were too costly to be affordable to most elderly citizens.

Only about one-quarter of the elderly could meet the entrance fees and monthly dues, the congressional agency found.

Thus the taxpayer-provided bond subsidy benefited a small segment of society — wealthy elderly people.

An Inquirer review of the financial operations of Philadelphia-area nonprofit retirement centers financed in whole or in part with tax-exempt bonds showed that some

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offered reduced rates to a limited number of people. But charity cases were few.

At Dunwoody Village, a retirement center in Newtown Square, 10 residents were considered charity cases out of a population of 360. The 10 charity cases were supported by interest income generated by a $1.4 million trust.

Dunwoody sold $11 million worth of tax-exempt bonds last year through the Delaware County Authority. Officials said proceeds from the offering would be used to demolish the William H. Dunwoody Home, a residence built in 1924 that had housed some residents. A modern nursing care unit would be added.

To get into the nonprofit home, a retiree must pay $53,000 for a single studio unit and up to $195,000 for a two-bedroom deluxe country house. In addition, annual service fees range from $16,824 to $37,248.

Many people finance their entrance fees by selling their family homes. To meet the monthly fees, a couple would have to have annual retirement income ranging from $28,000 to $62,000, according to information in Dunwoody's bond filing.

A consultant's study for Dunwoody by Arthur Andersen & Co. showed that the nonprofit's primary market area includes such Main Line communities as Bryn Mawr, Haverford and Wayne. Even with such wealthy areas to draw from, Dunwoody was within the financial reach of about two of every 10 residents 70 years and older in those areas.

Another local retirement center financed with tax-exempt bonds is White Horse Village, which is on 83 acres of a former thoroughbred horse farm in Delaware County.

The 400 retirees at White Horse Village live in cozy villas or apartments and dine in an elegant hall where jackets and ties are required. A branch of Fidelity Bank operates four afternoons a week. If a resident becomes ill, there's a full-service nursing home.

Entrance fees at White Horse Village last year ranged from $78,400 for a studio apartment to $251,400 for a villa. Monthly fees run from $1,075 to $2,435.

Management of the nonprofit recommends that prospective members have retirement income of at least $30,000 a year to move into the smallest of the apartments.

That financial requirement would exclude three-fourths of all households in the nation with people 65 or older, U.S. Census data show. The recommended annual income of $50,000 for an upscale villa would eliminate nine of 10 older households.

The IRS counts the retirement center as a tax-exempt nonprofit. Started by a for-profit developer, the center was later completed with $48.5 million worth of tax-exempt bonds issued by the Delaware County Authority.

The proliferation of bonding authorities and the patchwork approach to government supervision often means that one agency doesn't know what another is doing.

Take the American College, a nonprofit that offers correspondence courses in insurance and finance and seminars on its leafy campus just outside the center of Bryn Mawr.

In 1984, the Board of Assessment Appeals of Delaware County revoked the college's property tax exemption, contending that it benefited the insurance industry more than the general public.

The school appealed the ruling to Delaware County Court, Commonwealth Court and finally to the Pennsylvania Supreme Court — losing at each stage.

The various courts ruled that the college did not meet the threshold required of charities to earn a property tax exemption. As a result, the college was required to pay almost $2.5 million in back taxes.

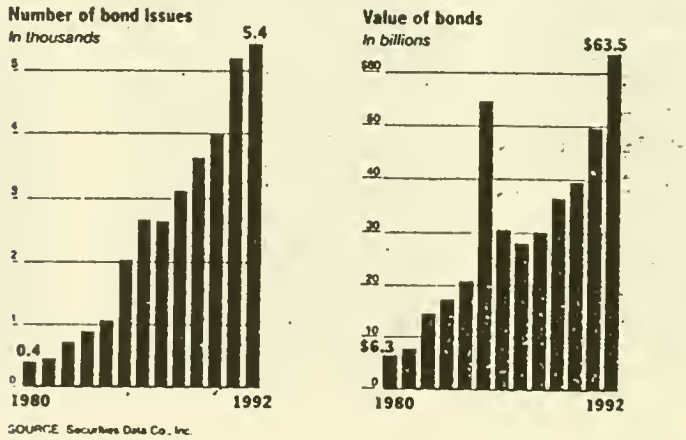
That left American College with a problem — raising the money to pay the back taxes.

American College not only figured out where to get the $2.5 million, but also another $3 million to pay off debts.

Thanks to the agreeable folks at the Delaware County Authority, American College was allowed to sell $5.5 million worth of tax-exempt bonds.

■ **Tomorrow:** Tax-exempt foundations make more money than they give away. Thus, the moneybag grows.

Tax-exempt Bonds: A Stream of Cheap Money for Nonprofits



SOURCE: Securities Data Co., Inc.

The Philadelphia Inquirer

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Nonprofits lobby like everyone else

They form their own political action committees to influence legislators, contribute to candidates

By Gilbert M. Gaul and Neill A. Borowski
INQUIRER STAFF WRITERS

When it comes to special-interest politics, nonprofit groups play the game as well as anyone. And they do it the old-fashioned way: with money, especially PAC money.

Take the National Cattlemen's Association, a tax-exempt trade group for ranchers, based in Englewood, Colo. It is one of hundreds of nonprofit groups that lobby Congress every year.

You thought nonprofit organizations weren't allowed to politick?

Wrong.

Under the tax code and election laws, only charities — not other nonprofits — are prohibited from participating in political activities.

But even charities can set up separate nonprofit organizations under a different section of the tax code to lobby Congress and form political action committees.

The cattlemen figured out years ago how to play the game. Their nonprofit association divides its efforts among lobbying, promotion and professional activities. Like other trade groups, it spends heavily to gain access to lawmakers, particularly those who regulate the cattlemen's business.

Between May 1987 and February 1990 the Cattlemen's Association distributed honoraria and speaking fees totaling $16,000 to 16 members of Congress, 13 of whom sat on key agriculture and interior committees, campaign finance records show.

Between January 1989 and June 1992, the cattlemen's PAC contributed $564,104 to Washington legislators. Contributions were tilted toward members of agriculture committees.

What do ranchers want from Congress?

For starters, there's the federal lands grazing program, a taxpayer-subsidized arrangement in which livestock owners get to graze their cattle on government lands at very cheap rates.

In 1991, the Bureau of Land Management awarded more than 30,000 grazing permits. Ranchers paid $1.97 a month for each head of cattle — about one-fourth the grazing charge for private land.

According to the General Accounting Office, a relatively small group of wealthy investors and big corporations control nearly half of the public lands under permit. A June 1992 report by the congressional agency said that 500 individuals and corporations — or about 2 percent of all permit-holders — controlled 76 million acres of public range lands.

Among the select 500: Metropolitan Life Insurance Co., Sierra Pacific Resources, Pacific Power & Light, Texaco and a number of millionaire rancher-investors.

"It's outrageous that the American taxpayer is forced to subsidize millionaires like Laurence Rockefeller and huge corporations like Metropolitan Life and Getty," Rep. Mike Synar (D., Okla.) said after the GAO report was released.

Synar estimates that the government could be getting an additional $75 million to $100 million annually. But his repeated attempts to raise grazing fees to market levels "to give federal welfare cowboys a good dose of free enterprise" have not been supported by his congressional colleagues.

Ranchers and their lobbying associations say the fees are appropriate and take into account some hidden costs, including the expense of maintaining the property.

In all, more than 1,000 nonprofit groups have set up tax-exempt networks to lobby for their special interests. They include a broad range of business, advocacy and political groups. Usually, they are lobbying for federal bounty. For example:

• WHEATPAC, the political action committee of the nonprofit National Association of Wheat Growers, contributed $120,000 to members of Congress between September 1988 and June 1992, with half going to key agriculture committee members. Federal subsidies for wheat growers totaled nearly $3 billion in 1991.

• The National Cotton Council distributed $21,000 in honoraria to 12 members of the House Agriculture Committee between December 1986 and September 1990. One legislator, Rep. Jerry Huckaby (D., La.), received $9,000. Huckaby is chairman of the Agriculture Subcommittee on Cotton, Rice and Sugar. The council's Political Action Committee for the Advancement of Cotton contributed $498,538 to campaigns of federal lawmakers between November 1988 and June 1992, much of it to key agriculture committee members. Federal subsidies for cotton growers totaled $382 million in 1991 and an estimated $1.3 billion in 1992, according to the U.S. Agriculture Department.

• The American Sugarbeet Growers Association, a nonprofit trade group, awarded $14,000 in honoraria and speaking fees to members of Congress between 1988 and 1992 and another $795,140 in campaign contributions through its PAC. A federal quota system that limits the importation of cheaper foreign sugar results in artificially high prices for domestic sugar.

Spokespersons for these and other nonprofit trade and advocacy groups say they simply are trying to establish a political presence. And one way you do that is with money.

"Whether it's the AMA, the Tobacco Institute, the National Association of Realtors or the Teamsters, you want to be part of the political process," said Walker Merryman, vice president of the tax-exempt Tobacco Institute. "It doesn't guarantee you anything. But it ensures that members of Congress and our groups can meet and talk about issues that have a direct bearing on us."

Needless to say, the overwhelming majority of individual taxpayers don't have this level of access — even though they are indirectly underwriting the lobbying efforts of special interest groups. Nor do they enjoy the tax breaks these groups get.

The Tobacco Institute is a good example of how an industry gains access. Between June 1986 and December 1990, it gave out $537,676 in speaking fees to more than 100 members of Congress, including most of the House Agriculture Subcommittee on Tobacco and Peanuts. Charles G. Rose (D., N.C.), subcommittee chairman, received $10,000 in five separate $2,000 payments.

"We invited members of Congress to speak to groups of tobacco industry executives in Washington and also at our annual legislative conference," Merryman said. "Most of the time, members would speak about issues that had a direct bearing on us — taxes, advertising, that sort of thing. They might comment on pending legislation or legislative trends they knew about that might affect us."

In 1989 House members agreed to a ban on speaking fees, effective in January 1991, in exchange for a hefty salary increase. That hasn't stopped legislators from accepting trips to Bermuda, Florida and California paid for by tax-exempt special interest groups.

Another tax-exempt group that invests heavily in lobbying and PAC contributions is the American Medical Association. Between 1981 and 1992, the doctors' group handed out more than $12 million — twice as much as the next highest health PAC.

During the 1980s, Congress began to look at ways to control rising federal reimbursements to physicians, which have increased an average of 13 percent a year since 1965. They now exceed $26 billion a year.

Medical PAC contributions have increased as Congress has taken up the issue of national health reform. The nonprofit group Common Cause reported that the health-care industry contributed more than $60 million to congressional candidates during the 1980s. Current members received $43 million of that.

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Warehouses of Wealth: The Tax-Free Economy

Last in a series.

Foundations became tax-exempt because of the grants they give. Now they earn far more than they give away.

Foundations build a giant nest egg

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS
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When a new president took over the Robert Wood Johnson Foundation in Princeton in 1990, he discovered a peculiar problem:

Money was coming in much faster than it was going out.

The foundation's investment holdings, mostly in Johnson & Johnson Co. stock and bonds, had tripled since 1981, to nearly $3 billion. While the assets had grown an average of 12 percent a year, grants had increased about 9 percent.

So in 1991 Steven A. Schroeder, the new president, decided the foundation needed to be more generous. And it was. It gave away $123 million.

But even as it stepped up its giving that year, the Robert Wood Johnson Foundation managed to hand out no more than 3 cents in grants for every dollar in assets.

Many large foundations give away equally small proportions of their wealth.

By distributing only the minimum required by law while their investments grow at a faster rate, tax-exempt foundations have become huge warehouses of wealth, where more money is stockpiled every year.

And more and more of the nation's wealth is sucked out of the tax base — leaving taxpayers to pay a larger share.

It wasn't supposed to be this way. The tax laws, particularly the Tax Reform Act of 1969, were intended to require tax-exempt foundations to give money away, not accumulate it.

But a quarter-century after Congress studied the impact of foundations on the economy, more wealth is concentrated in a smaller number of foundations than ever before.

Today, foundations distribute about $9 billion a year in grants. There is no question that this results in a lot of good. The issue is whether the nation can afford to have so much wealth removed from the tax base.

These are the titans of the nonprofit world, that growing tax-exempt sector of the American economy that now controls property, cash and investments worth at least $850 billion. About one-fifth of that wealth is controlled by foundations.

See FOUNDATIONS on A6

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Investing in more than worthy causes

FOUNDATIONS from A1

Since 1975 their assets have swelled from $30 billion to $163 billion, a fivefold increase, according to the Foundation Center. Even after adjusting for inflation, their assets more than doubled, thanks to a booming stock market and favorable tax rules.

Foundations pay no income tax on this hoard of money. While businesses pay as much as 34 percent in income tax, a foundation typically pays only a 1 percent excise tax on income from its investments.

If foundations were taxed at the full corporate rate on their income, which totaled nearly $9 billion in 1989, the federal government would have collected roughly $3 billion in taxes. Today, the estimated taxes would be about $4 billion.

Their proponents — mainly foundations themselves and those who benefit from their charity — say that private foundations are uniquely able to support innovation in social programs and research.

Their opponents say they are tax shelters for the wealthy, a means by which a small, privileged class can continue to control billions of dollars while shifting the tax burden to people without substantial income.

"It has been much easier to make money than to spend it wisely," the late W.K. Kellogg, who established his own foundation in 1930, once said.

His decades-old quote describes the position of many of the largest foundations today: Most appear to concentrate more on making money than on spending it — wisely or not.

The bulk of the $163 billion in foundation wealth is held by a few giants, under the control of self-perpetuating boards answerable only to themselves.

Although there are 33,000 foundations in the United States that make grants, the 10 largest account for 20 percent of all assets and 12 percent of the grants.

In the last two decades, control over this wealth has become even more concentrated.

In 1972, the chairman of the House Banking Committee expressed alarm that 1 percent of foundations controlled 63 percent of all assets. Today, 1 percent controls 66 percent.

Operated like private banks or trusts, large foundations typically give away little more than the minimum required by law — the equivalent of 5 percent of their assets every year.

When the 5 percent requirement was set by Congress 17 years ago, it seemed like a fair amount. But since the run-up in assets during the 1980s, the adequacy of the 5 percent rule is less evident today.

Even that minimum payout is flexible. Five percent doesn't mean that 5 percent must be distributed each year to grant recipients. Allowable expenses, such as administrative costs of making the grants, can reduce it.

Take the foundation created by the late Robert Wood Johnson, who built a family business, Johnson & Johnson, into one of the biggest companies in the medical products industry. The Johnson foundation focuses its interest on health-care issues.

In 1990, its assets totaled $2.9 billion, according to the foundation's annual report. However, a more narrowly drawn definition of assets permitted by the IRS showed it with $2.6 billion in assets on the foundation's 1990 tax return. A lower asset level means the 5 percent spending level for grants also is less.

The $2.6 billion in assets meant the foundation had to show about $130 million in "qualifying distributions" on its tax return to escape paying a 2 percent excise tax as a penalty for not paying out enough.

Where did the $130 million go? Nearly $11 million was in administrative expenses, such as salaries for program managers; $3 million was paid in program-related investments, $4 million in other expenses and nearly $46 million was in funds pledged but set aside for future grants.

The balance — about $66 million, or the equivalent of 2.5 percent of the assets — actually went out in grants, according to the tax return.

Between 1990 and 1991, Schroeder's first year as president, assets grew by more than $1 billion, to a total of $4.1 billion — propelling the foundation from sixth largest to third largest in the nation.

In 1991, income and gains on the sale of securities totaled about $272 million. The year before, they totaled $285 million.

If the Robert Wood Johnson Foundation were a business, its tax bill each of those years could have been more than $30 million. The foundation actually paid $2.64 million in excise taxes each year, the equivalent of 1 percent of the income.

Last year, the foundation's assets declined to $3.7 billion, said controller G. Russell Henshaw. It awarded $221 million in grants — a record. Nevertheless, that payout amounted to just 6 cents on every asset dollar.

Shouldn't a foundation pay out more?

"You can argue it both ways," Schroeder said. "I'm not convinced as to the answer."

He described it this way: "You have to ask yourself, well when is the next AIDS epidemic coming? Or when is the bottom going to drop out? We'll face that more, if and when our assets decline, than in times of growth.

"If an exceptional opportunity comes up ... we'll go past the 5 percent. Five percent is an operational standard."

Although some critics say foundations should distribute their money for the purpose intended and go out of business, the trustees of the Johnson foundation, created in 1972, view it as a permanent entity. Besides making grants, the goal is to preserve the foundation's "corpus," or core assets, so it can survive, even in the face of inflation.

Doing that, Schroeder said, is more difficult than just keeping pace with the overall inflation rate. Inflation in health care, the foundation's area of interest, has been running about twice the overall consumer rate.

"We can't keep up with health-care inflation anyhow," he said. If the foundation spent down its assets, "we'd have less of a chance."

Increasing their wealth year after year has had another effect. Foundations have become an industry, requiring layers of well-paid executives, managers, investment advisers and trustees.

■

Joanne Sage and Helen Pariza sit face-to-face in a crowded Manhattan office, surrounded by colorful computer screens flashing stock prices and up-to-the-minute financial news. Fifteen telephone lines ring automatically into major brokerage houses, with brokers on the other end waiting to hear "buy" or "sell."

With 13 other financial professionals, Sage and Pariza are responsible for the care and feeding of more than $6 billion in assets. They nurture a stock portfolio of more than 50 million shares in about 100 companies. Colleagues have other duties, from analyzing the potential of specific companies to managing billions of dollars in bonds.

These professionals have done a good job. In the last 10 years, the assets have more than doubled. They have grown by nearly three times the consumer inflation rate.

This could be a success story for a large mutual fund. Or the tale of some hot Wall Street traders. But it's not.

This is the Ford Foundation, the nation's largest grant maker, most often associated with charitable programs aimed at poverty, education and health around the world.

At the Ford Foundation, everything is big. Its 12-story glass-and-steel headquarters in New York surrounds a lush, one-third-acre garden under a skylight 160 feet above. The foundation's 607-page 1991 tax filing is five inches thick. While 2½ inches are devoted to grants, two inches detail one year of capital gains and losses in trading securities.

The highest-paid employees at the Ford Foundation in 1991 — not including officers and directors — were those responsible for making sure the assets continue to multiply.

Richard Hopkins, the highest-paid employee that year, received $414,298 in salary and benefits as director of fixed-income investments; Linda Strumpf received $410,402 as director of equity investments, and Allen Faurot was paid $333,109 as director of special investments.

The Ford Foundation, established by Henry and Edsel Ford in 1936, today is the nation's wealthiest foundation and the granddaddy of grant makers.

In 1991, Ford distributed $241 million — an amount 57 percent larger than second-ranked W.K. Kellogg Foundation. Even though it wrote checks for hundreds of millions of dollars, Ford's grants still amounted

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They may say it's a secret, but you have a right to know

By Gilbert M. Gaul
and Neill A. Borowski
INQUIRER STAFF WRITERS

The growth of America's public charities and nonprofit organizations has given rise to a culture of secrecy that rivals the most private companies.

Ask a large charity or nonprofit to see a copy of its tax return and you may be told the following:

- Write us a letter stating why you want to see it.
- How about if we send you a copy of our annual report instead?
- We don't have to show it to you.
- You can see it, but you can't write about it without our permission

"It is my understanding that you will not use the name of our organization without obtaining prior approval from the executive director," Darcy E. Wertz of the nonprofit organization U.S. English advised an Inquirer reporter who had asked for the group's IRS filing.

The tax-exempt purpose of U.S. English? It advocates English as the nation's official language. Wertz is the group's human resources manager.

The U.S. Tax Code requires nonprofit groups to show to anyone who asks for it their original application for tax-exempt status as well as the last three years of their informational tax return, known as a Form 990.

These documents must be kept on file at the organization's offices for public inspection. Individuals also may request copies of 990s by writing to the IRS.

As part of these filings, charities must list the salaries and benefits of the five highest paid officers and directors earning more than $30,000 a year. Another part of the form calls for the five highest paid employees. Yet another asks for the five highest paid consultants.

These disclosure requirements are supposed to serve as a check in the government's otherwise meager oversight of nonprofit groups.

"There will always be more organizations than the IRS and state attorneys general can keep tabs on," said Marcus S. Owens, director of the IRS's Exempt Organizations Technical Division. "By making the 990s available, it was hoped that the spotlight of publicity would serve as a kind of a check."

It doesn't always work that way.

Many tax-exempt groups resist when it comes to revealing details about their finances, especially executive salaries and perks. They've discovered a multitude of tactics to divert, or even subvert, the interest of citizens.

These tactics include leaving crucial information blank in IRS filings; refusing to provide returns to people who ask; and shifting management functions to private, profit-making firms to avoid disclosure.

For example, under state law Independence Blue Cross is considered a nonprofit organization and pays no income tax, sales tax or insurance premium tax. Yet officials refuse to provide any information about the compensation paid to their top executives.

"These returns contain highly confidential and competitively sensitive business information, the disclosure of which could impact negatively on the business initiatives of Independence Blue Cross," general counsel Patricia R. Hatler wrote in response to a 1989 request for information.

Court records show that former Blue Cross president David S. Markson was paid $495,000 in salary and bonuses in 1987. Other Blue Cross and Blue Shield executives nationwide receive salaries ranging from $300,000 to more than $750,000, state insurance records show.

Another tax-exempt group that declines to disclose salary information for key officers is the Allegheny General Hospital group, which controls Medical College Hospitals in Philadelphia.

In 1988, the Pittsburgh organization set up a separate corporation, Centennial Health Services, to pay executives and handle other management functions. Although incorporated as a nonprofit organization, Centennial pays federal and state taxes.

As a result, Centennial does not have to make its tax return public, an attorney said. A hospital spokesman said the information is considered "privileged."

The situation is similar at Quakertown Community Hospital in Bucks County. The small, nonprofit hospital is managed by American Health Resources Systems Inc., a profit-making firm that employs seven top executives of the hospital.

What if a citizen of Quakertown wanted to check those salaries?

"We are a private institution. We consider payroll private," Michael Hammond, Quakertown's administrator in 1992, said. He has since left the company.

Some large nonprofits file returns with the IRS but omit information on officers' and directors' salaries.

For example, Hadassah, a tax-exempt Jewish women's service group in New York City, wrote on its 1990 IRS return that salary "information is confidential and will [only] be supplied upon request."

The United States Golf Association Inc. in Far Hills, N.J., took a similar approach.

Planned Parenthood Federation of America noted that five employees were paid between $121,192 and $200,000 each. It left out their names on its IRS return.

The Museum of Modern Art in Manhattan lumped together the salaries of its highest paid officers and employees but failed to disclose individual salaries in a return filed with the IRS. A return on file at the museum contained salary data.

Ducks Unlimited Inc., a conservation group, listed benefits but not salaries.

Owens said the IRS position was that the information on salaries and loans made to executives by nonprofits must be disclosed in the forms. "It has to be public," he said.

Then how do incomplete filings slip by?

The federal agency has fewer than 500 employees to monitor the half-million Form 990s filed annually by charities and other nonprofits. Most returns are never examined. Organizations can skirt disclosure rules with virtual immunity.

IRS officials acknowledged as much during a 1991 congressional hearing.

"I can tell you that we routinely attend health law seminars throughout this country. We have on many occasions listened to presentations from tax practitioners advising those who attend the seminar how best to avoid the requirements," James J. McGovern, IRS associate chief counsel, said.

Some executives at large nonprofit groups apparently are not familiar with federal disclosure requirements.

When a reporter told Frankford Hospital president John B. Neff that the hospital's Form 990 excluded his salary, Neff said, "I don't know these forms. I never see them. I'm going to play dumb and say I've never paid attention to it. I don't have a clue."

Officials at Franklin Square Hospital couldn't find their own tax return. "At present, I haven't located it," Charles Carlson, the hospital's chief financial officer, said late last year.

Thomas A. Sullivan, treasurer of the National Football League, initially told a reporter the nonprofit didn't have to make its IRS returns public. After reviewing the law, Sullivan reversed himself.

"Thank you for making us aware of the law," he said. "No one ever asked us before. We really didn't know what we were required to do. Now we know."

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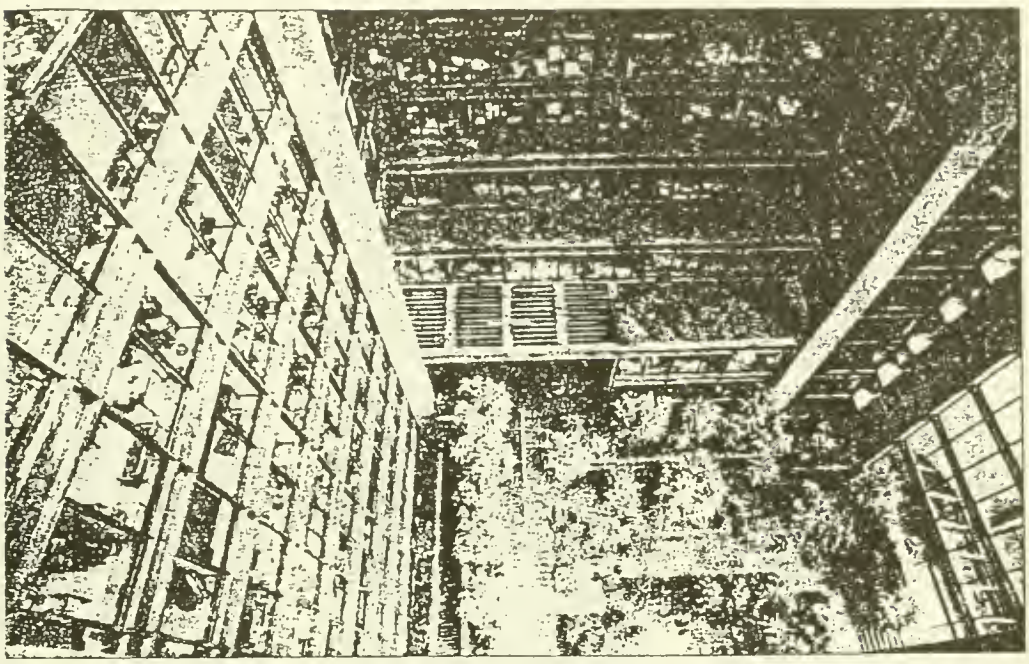
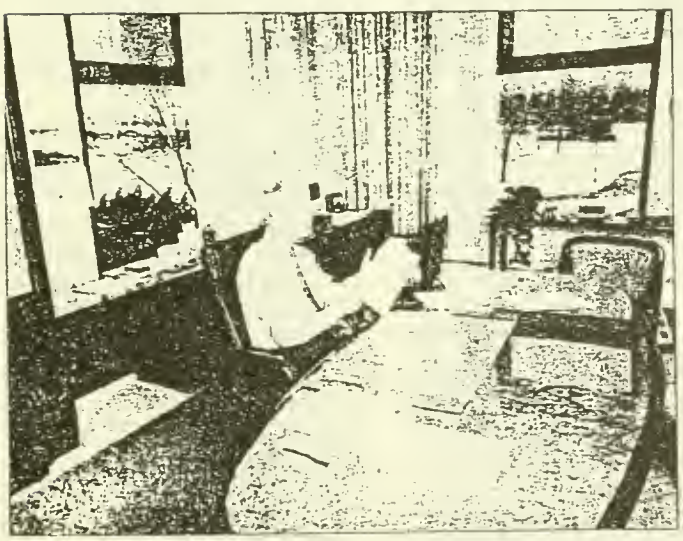


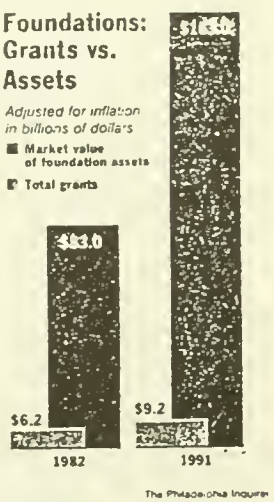
The Philadelphia Inquirer MICHAEL MALLY

The Ford Foundation's headquarters in New York features a one-third-acre garden 160 feet below a skylight in the 12-story building. In 1991, Ford gave $241 million in grants. It is the nation's wealthiest foundation.



The Philadelphia Inquirer MICHAEL MALLY

In Steven A. Schroeder's first year as president, the Robert Wood Johnson Foundation gave away more money than before — $123 million. Also that year, assets grew by more than $1 billion. Schroeder said that if an "exceptional opportunity" arose, the foundation would give away more than the law requires.



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to only 4 percent of its assets.

In the latest fiscal year, 1992, Kellogg and Ford were neck and neck for the distinction of wealthiest foundation. Kellogg's assets, most of it in Kellogg Co. stock, reached $6.45 billion. Ford's assets were $6.47 billion.

Their wealth has made foundations such as Ford, Rockefeller, Kellogg and Robert Wood Johnson among the nation's most economically powerful institutions. How they vote their stock — and where they invest their money — carry great weight on Wall Street and in corporate boardrooms.

Because many foundations were established with large blocks of donated stock, they have had significant influence and control over some of the largest corporations.

A 1972 congressional study, the first to try to assess the effect of tax-exempt foundations on the economy, said: "There is reason for concern when such power is held by a relatively small and select group who can perpetuate themselves in office, and who never have to face the scrutiny of a public that is affected daily by their autonomous action."

The Internal Revenue Service has defined a foundation as a "private, nonprofit organization with a narrow base of financial support whose goal is to maintain or assist social, educational, religious or other activities deemed to serve the public good."

That narrow base has narrowed even more.

As their income has grown, the larger foundations have come to rely less on contributions from the public. They have become self-sustaining, no longer needing benefactors.

In 1990, the Ford Foundation, for example, received no contributions or gifts, its tax return shows. The foundation earned $55 million in interest on savings and $259 million on dividends. It paid out $237 million that year in charitable grants.

Only about one-fifth of the revenue of large foundations came from contributions in 1989, whereas smaller ones depended on donations for two-thirds of their revenues.

There is another difference between large and smaller foundations' their generosity.

The largest foundations give out the least in proportion to their wealth. In 1989, foundations with $100 million or more in assets paid out exactly 5 percent, according to an Internal Revenue Service study. The smallest foundations, those with less than $100,000 in assets, paid out about 11 percent. The overall average was 7 percent.

The IRS study found that in 1989 large foundations gave away in charity an amount equal to one-half of their investment income. In contrast, smaller foundations gave away twice as much as their investments earned.

Smaller ones often act as a conduit, turning contributions they receive into grants.

■

Congress periodically has become concerned about the financial control over U.S. businesses exerted by foundations through their stock holdings. Over the years, members of Congress have proposed a number of changes in the law. Many of the proposals were ignored; in some cases, stricter rules that did get adopted later were softened.

Although foundations have accomplished much good, altruism was not always the motivation behind their founding.

Many were established as tax shelters — a means of preserving a family's or corporation's wealth by shielding stock from inheritance or income taxes while retaining voting control over those shares.

Even before the income tax was adopted in 1913, official Washington was eyeing the foundations that had been set up by corporate chieftains and worrying whether they would become mere repositories of wealth.

A congressional commission in 1912 recommended that foundations be required to distribute all their income every year. They would not have been required to pay out more than 10 percent of their assets.

As Congress was developing income tax law between 1913 and 1917, there was some concern that taxing incomes would cause people to cut their charitable giving. So philanthropic organizations were exempted by Congress and taxpayers were permitted to

Continued on next page

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deduct their gifts to these organizations.

Through the deduction, an IRS study says, "the federal government effectively subsidizes charitable activities."

In 1934 tax-exempt foundations were prohibited from lobbying. In 1943, foundations and other tax-exempt groups were ordered to begin filing informational tax returns, even though they were exempt from income taxes.

And in 1950 several regulations were imposed on foundations, including ones governing the taxing of business income unrelated to their exempt purpose and public disclosure of their finances.

An issue debated for some time had been whether tax-exempt foundations should be allowed to become self-perpetuating charities or should be required, in effect, to spend themselves out of business.

An advisory committee in 1954 said a foundation's life should be kept to 10 to 25 years. All income would have to be distributed in two to three years. That recommendation never became law.

Fifteen years later, when Congress was considering the Tax Reform Act of 1969, it was proposed that a foundation should have a tax-exempt life of no more than 40 years. That didn't make it into law, either.

Congress was sufficiently concerned about the power and influence of foundations in 1969 to attempt to rein them in. That year, lawmakers required foundations each year to give away either their net income or 6 percent of their assets, whichever was greater. The 6 percent floor for distributions was cut to 5 percent in 1976.

The 1969 law also prohibited foundations from owning more than 20 percent of the voting stock in any corporation, except for those that already owned a larger share.

Before 1969, there had been no minimum payout requirements, although the IRS could revoke a foundation's tax exemption if the agency believed it wasn't giving away enough. The IRS "rarely applied this penalty due to its severity," an IRS study says.

The lack of monitoring of foundations was called a "major loophole in our system of taxation" by a 1972 study released by the House Banking Committee. The Internal Revenue Service was chastised for its "laxity" in carrying out its responsibility.

The study also found that "many of these private foundations have been used as a vehicle for perpetrating control over a substantial portion of our nation's wealth by a select few, chosen for financial status or prestige rather than democratic means."

To pay for better monitoring by the IRS, Congress imposed a 4 percent excise tax on foundations' investment income in 1969. By 1978, the tax had been cut to 2 percent, and in 1985 foundations were allowed to begin paying only 1 percent if their grants reached the 5 percent threshhold.

Nevertheless, some foundation executives say they have received too much attention from Congress and the IRS.

"Congress does not like private philanthropic foundations, and, in all likelihood, never will," wrote Terrance Keenan, a longtime official of the Robert Wood Johnson Foundation, in a booklet published in September examining the prospects for foundations in the 1990s.

In a section titled "The Rocky Road of Regulation," Keenan wrote that although Congress is subject to public accountability, it "is very uncomfortable with the foundation as a center of power and wealth which has no such accountability. The congressional hostility toward foundations has been manifest since the passage of federal income tax legislation."

■

When visitors arrive to meet with executives on the 23d floor of the Freedom Forum's headquarters in Arlington, Va., it's hard to avoid being distracted.

A large, plush anteroom with sofas, chairs and a huge wood-burning fireplace, draws you in. A wall of windows offers a panorama of the nation's capital.

To one side is the office of Charles L. Overby, the Freedom Forum's president. To the other side is the office of Allen H. Neuharth, the foundation's part-time chairman. One wall of the reception room is covered with framed photographs of Neuharth, smiling and greeting a variety of world leaders.

In the foundation business, it costs a lot to give away money. And few foundations spend more giving it away than the Freedom Forum and Al Neuharth.

So much, in fact, that it is under scrutiny by the New York Attorney General's Office, which is investigating whether its expenditures have been excessive.

The Freedom Forum, formerly called the Gannett Foundation, is a major funder of journalism programs. In fiscal year 1992, it spent $1.71 in administrative costs for every $1 spent in contributions, gifts or grants, according to its tax filing for that year.

That was eight times more than the average for all foundations — 20 cents in administrative costs for every dollar in grants.

The Freedom Forum had $698.5 million in assets in 1992. Administrative expenses totaled $34.4 million; grants and gifts were $20.2 million.

Tax records show that in three years, administrative costs grew from 36 cents for every grant dollar (1988) to $1.14 (1989) to $1.18 in 1990.

In that period, the foundation moved from Rochester, N.Y., where it was created in 1935 by newspaper publisher Frank Gannett, to new headquarters it leases on the top three floors and the rooftop of a glass tower across the Potomac from the capital.

The foundation also built a high-tech rooftop conference center, featuring a wall of video screens and elaborate production equipment. Often executives in Arlington meet via video teleconferences with officials of the foundation's study centers in New York and Nashville.

An analysis of the Freedom Forum's tax filings shows that between 1989 and 1992 spending on salaries doubled, spending on pensions and benefits nearly tripled, occupancy expenses nearly quadrupled; and spending on travel and conferences quadrupled.

The board of trustees has held meetings in Hawaii and Puerto Vallarta, Mexico, where forum officers met with Mexico's president. Last May, Neuharth and other officers and trustees went on a fact-finding mission to Russia to show support for a free press there.

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Neuharth, 69, former chief executive of Gannett Co Inc., which publishes USA Today and other newspapers, was paid $131,000 as head of the foundation in 1992. John C. Quinn, 67, a former Gannett Co. executive, was paid $110,708 as part-time vice chairman. Neuharth and Quinn live on the same street in Cocoa Beach, Fla. Overby, 46, the foundation's president who is also a former Gannett executive, received $278,040.

Executives of the foundation have said that its mission has changed substantially over the years. Instead of awarding grants in cities where the Gannett Co. has newspapers, as it once did, the foundation now spends most of its money funding media study centers at Columbia and Vanderbilt Universities and sponsoring conferences.

Neither Freedom Forum officials nor the New York Attorney General's Office would discuss the investigation.

At the rapidly growing John S. and James L. Knight Foundation, president Creed C. Black, 67, is a former publisher of the Lexington (Ky.) Herald-Leader, owned by Knight-Ridder Newspapers Inc. Black was paid $247,584 in 1991. The newspaper group includes The Inquirer and the Daily News.

The foundation, established in 1950 by the Knight brothers, has assets of more than $700 million. In 1991 it made grants totaling $25 million to schools, museums and social welfare groups, many in communities where Knight-Ridder has newspapers. The Knight Foundation's administrative expenses that year, $5 million, were the equivalent of 20 cents for each dollar paid out in grants.

Large foundations typically spend between 15 and 40 cents in administrative expenses for every dollar in grants, IRS filings show. The average spent in 1990 was about 20 cents for every grant dollar, according to data provided by the Foundation Center.

Salaries and benefits traditionally have been an area "where the potential for abuse is great," the pioneering 1972 congressional study on foundations said.

That study found that foundations on average were spending 50 cents on administration for every $1 in grants. "The cost of producing and distributing charitable benefits by private foundations is staggering by any standard," the study said.

"When funds that are intended for charity are selfishly and wastefully diverted to the administration and management of these foundations, it is charity that is being cheated," it said.

Today, a large share of administrative costs goes to investment advisers and consultants.

At the Ford Foundation, in addition to the highly paid in-house money managers, outside investment firms also collected large amounts. The five highest-paid consultants ranged from Templeton Investment Council Inc. of Atlanta, which was paid $476,823, to Baring International Investment Ltd. of London, which received $889,458.

In all, Ford Foundation's annual report says "expenses incurred in the production of income" in 1990 totaled $14.7 million.

In 1991, foundations paid out $9.2 billion in grants. What did they get for their money?

At the Ford Foundation, projects ranged from a $46,300 grant for a program to help low-income Camden residents commute to work to a $5.1 million academic grant to the National Academy of Science for doctoral minority fellowship programs.

"There are a lot of good projects out there and we can't fund all of them," said Barry Gaberman, deputy vice president of the Ford Foundation's program division, which is in charge of spending the foundation's money.

In 1992, the Ford Foundation received 33,000 grant requests and made 1,700 grants, for a total of $276.5 million.

When foundations are formed, their benefactors don't always stipulate how the money is to be spent. In some cases, grants are focused on specific problem areas. Robert Wood Johnson aims at health-care problems.

In 1991, the Robert Wood Johnson Foundation made a $1.3 million, three-year grant to the state of Indiana to develop affordable long-term health insurance for the elderly.

A three-year grant of $1.5 million went to Children's Hospital of Philadelphia for a West Philadelphia collaborative program for child health care. And a three-year grant of $139,799 went to the Aroostook Micmac Council Inc. in Presque Isle, Maine, to support a health care program for Native Americans.

The largest single grants from foundations in recent years have included $75 million from the W.M. Keck Foundation to California Institute of Techoology for a 10-meter telescope in Hawaii, $9 million from the William Penn Foundation to support the Philadelphia Ranger Corps' work in the city's parks and $7.5 million from the Andrew W. Mellon Foundation to endow three professionals at the National Gallery of Art in Washington.

And then there are the truly unusual foundations. Like the one named for Harriet DeTrampe of Haverford, who died at age 101. In her will, she made provisions for the Countess deTrampe Home for Unwanted Dogs in Green Lane, Montgomery County.

Today the foundation has $2.3 million in assets and maintains a home for about 25 dogs whose elderly owners either had died or had gone in a nursing home.

Some foundations promote religious views or work to influence public opinion. Arthur S. DeMoss was a Christian evangelist who founded National Liberty Life Insurance Co., a Valley Forge mail-order insurance firm, which he sold in 1979. That also was the year DeMoss, who was 53, died on his tennis court at his Bryn Mawr mansion.

DeMoss had set up a foundation in St. Davids, Delaware County, to "promulgate the Christian gospel throughout the world by any and all proper means."

Last year, the tax-exempt foundation funded a controversial television ad campaign promoting adoption for expectant mothers who didn't want to keep their babies.

The ads, "Life: What a beautiful choice," aired on national television and were widely viewed as being anti-abortion.

The advertising campaign was a major endeavor for DeMoss, which has assets of more than $400 million in 1991.

Control of the foundation remains with seven family members. They are led by Arthur's widow, Nancy S. DeMoss, who was paid $136,825 in 1991 to serve as chairman and chief executive officer.

In the case of the Annenberg Foundation, the primary mission is to fund communications schools at the University of Pennsylvania and the University of Southern California.

Many schools receive large donations from benefactors, with the understanding that they will be used for specific programs. But the Annenberg Foundation has a role in actually operating the communications schools at the private universities.

"The universities and the foundation jointly operate schools for the purpose of providing instruction in communication in radio, television and in other media," the foundation's 1991 tax filing says.

Although the Annenberg School's dean, Kathleen Jamieson, reports to Penn's administration, she is listed on the Annenberg Foundation's tax filing as its highest-paid employee — with compensation of $214,723.

Four other professors from Penn and USC are listed as receiving pay packages of more than $100,000. Half the members of the Annenberg School's board of trustees come from the foundation; the others are from Penn.

The foundation, based in St. Davids, is run by Walter H. Annenberg, former ambassador to Great Britain and former owner of The Inquirer. In 1992 its assets were $1.4 billion, making it the nation's 10th largest.

As president of the foundation, Annenberg was paid $150,000 in 1991, according to the tax filing. His office in St. Davids also received $350,000 from the foundation for professional services, which included investment accounting and administration. In addition to the communications schools, the foundation gave to other causes.

In 1991, the foundation contributed $5.9 million to operate Penn's Annenberg School and $4.4 million to USC.

It is a "unique funding mechanism," John W. Gould, acting executive vice president at Penn, said of the school's relationship to the foundation. Someday, he said, Penn officials hope the school will be endowed.

■

One reason for creating a foundation with a bequest is to do good. Another is to reduce a tax bill. Yet another, said Schroeder of the Robert Wood Johnson Foundation, is to build a "monument."

This monument isn't carved from stone. It's built with dollars.

It is this monument factor that worries Schroeder when he hears talk about stiffer tax rates on foundations or proposals to limit the life of foundations to only 10 or 20 years.

"I could have a ball spending the next 10 years wiping out this $3.4 billion. Don't get me wrong. I think it would be an incredible thing to do," he said. But rules limiting foundations could put a damper on philanthropy, Schroeder said.

"To the extent that donors give partly to have a monument to themselves or their family, and you create disincentives to do that, then you turn down the spigot, or turn off the spigot, on the bequesting of philanthropic wealth," he said.

But to some, a generous yet short-lived foundation isn't such a bad idea. In fact, those were the orders in the will of multimillionaire Lucille P. Markey, who died in 1982.

Markey's family fortune came from the Calumet Baking Powder Co. and, later, Calumet Farm — a leading breeder of thoroughbred horses. Markey and her husband had many Kentucky Derby winners and invested in oil and gas, which turned into millions.

Before Markey died in Miami she wrote her will and was precise in her wishes for what today is the Lucille P. Markey Charitable Trust. This trust, which started out with $250 million, should last no longer than 15 years after her death, she stipulated.

Markey was a private woman and wanted to make sure how her money was spent, said Nancy W. Weber, the foundation's director of program administration. "She wanted people she knew to manage the trust," and named them in her will, Weber said.

The philanthropist wanted the money to go for basic medical research. She knew that some long-lasting foundations had been formed to find a cure for a disease and after a cure was discovered, the foundation had to find something else to do with the money. "She did not want her money to outlive the

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purpose," Weber said.

As of last year, the Markey Trust had $169 million left. New grants totaling $56.5 million were authorized. The relatively low-budget trust, which operates with 10 employees in a former Miami law office (the trust bought the law firm's used furniture when the firm moved out), will be out of business in 1997.

Too modest an end for a generous benefactor?

Not at all, Weber said. "She did not want this big organization or buildings named after her."

Contributing to this series were Teresa Bank of the Inquirer library staff and editorial assistant Bing Mark.

10 Largest Foundations*

Not adjusted for inflation.

		1991			1990			CHANGE BETWEEN 1990-1991	
	FOUNDATION	ASSETS	GIVING†	GRANTS AS PERCENT OF ASSETS	ASSETS	GIVING†	GRANTS AS PERCENT OF ASSETS	ASSETS	GRANTS
1	Ford	$6,253,006,737	$240,875,343	4%	$5,460,896,289	$227,828,194	4%	15%	6%
2	W.K. Kellogg	5,396,889,094	153,942,541	3%	3,509,461,224	121,974,324	3%	54%	26%
3	Robert Wood Johnson	4,081,388,000	123,268,000	3%	2,914,183,000	76,760,000	3%	40%	61%
4	Lilly Endowment Inc.	3,592,519,250	131,309,773	4%	3,543,648,222	107,930,515	3%	1%	22%
5	John D. and Catherine T. MacArthur	3,393,492,922	122,991,197	4%	3,077,581,000	115,675,981	4%	10%	6%
6	Pew Charitable Trusts	3,338,048,594	109,264,608	3%	3,076,891,792	155,113,636	5%	8%	–30%
7	Rockefeller	2,171,548,237	86,906,769	4%	1,971,970,559	84,723,570	4%	10%	3%
8	Andrew W. Mellon	1,701,863,355	86,871,015	5%	1,617,441,434	74,467,370	5%	5%	17%
9	Robert W. Woodruff	1,495,171,323	33,372,418	2%	995,893,546	26,448,425	3%	50%	26%
10	Annenberg	1,477,010,631	53,374,300	4%	1,196,093,214	59,559,779	5%	23%	–10%
Top 10 total		**$32,900,938,143**	**$1,142,175,964**	**3%**	**$27,364,060,280**	**$1,050,481,794**	**4.0%**	**20%**	**9%**

* Does not include J. Paul Getty Trust, an operating foundation that runs a museum. †Awards made, not all disbursed that year

SOURCE: Foundation Center and Robert Wood Johnson Foundation

A World Dominated by Giants

$163 billion in assets

Approximately 33,000 foundations

The Philadelphia Inquirer C. CHANGSERLIN

STATEMENT ON

UNFAIR COMPETITION FROM PUBLIC AGENCIES

by

GARY WIGHT, CHAIRMAN
GOVERNMENT AFFAIRS COMMITTEE,
NATIONAL ASSOCIATION OF RV PARKS & CAMPGROUNDS

US HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON PROCUREMENT, TAXATION AND TOURISM

REP. JIM BILBRAY, CHAIRMAN

MAY 11, 1993

STATEMENT OF THE
NATIONAL ASSOCIATION OF RV PARKS & CAMPGROUNDS

presented by
Gary Wight
Park Washington Management, Inc
Bothell, Washington

Hearings on Unfair Competition
House Subcommittee on Procurement, Taxation & Tourism
The Honorable Jim Bilbray, Chairman

May 11, 1993

Mr. Chairman, Members of the Committee. I am Gary Wight, president of Park Washington Management of Bothell, Washington. Park Washington is a developer and operator of recreational vehicle parks and campgrounds in the state of Washington. I am honored to serve this year as First Vice President and Chairman of the Government Affairs Committee of the National Association of RV Parks & Campgrounds, the nation's only trade association representing the outdoor hospitality industry of RV parks and campgrounds.

The RV park and campground industry is comprised entirely of small businesses. We are proud to be an integral part of that portion of American enterprise that provides a majority of American jobs and which is, as they say, the engine that drives the US economy.

Our industry is comprised of more than 10,000 businesses with a gross revenue in excess of $5 billion and employing more than 60,000 people full time and an additional 60,000 on a seasonal basis. We estimate total payroll in the $1.6 billion range. We serve approximately 25% of the American population or some 70 million citizens who, according to surveys, indicate that they are campers. In 1991, we estimate that the commercial RV park and campground sector accounted for more than 81 million camper nights in these facilities and some $210 million in sales taxes and occupancy taxes. And campgrounds and RV parks purchase some $2.8 billion dollars of goods and services, most of which is purchased locally making the industry an important economic factor in smaller, rural communities across the country.

secure primitive, backcountry or wilderness experiences. All other facilities on public lands that are developed in a manner generally associated with the private sector should be operated on a business-like basis by the private sector.

It is our firm conviction that the role of government should be limited to protecting and preserving the health, safety and well-being of its citizens and that government should not be a primary provider of services. It should not duplicate or attempt to improve upon commercial services offered in the private sector. It should not undertake activities which lead to, or involve, providing services which are already provided by private sector companies. Nor should the government subsidize such services through its power to tax or confer other special advantages, thereby giving government or non-profit agencies advantages over the private sector.

Our association receives several letters each week from members and non-members citing examples of unfair competition. Let me cite just four examples that illustrate the issue as we see it.

In Arizona, a private businessman purchased an existing campground and, with the assistance of an SBA guaranteed loan, proceeded to upgrade and rehabilitate the facility. During his pre-purchase due diligence, his appraiser and the prospective purchaser visited the local headquarters of the Tonto National Forest to ascertain their development plans in the immediate area. He was told by Forest Service personnel that there were no existing plans to add camping facilities. Based on this information and other unrelated judgements, he purchased the property. Shortly thereafter, he learned of the Forest Service's intentions to construct a 100 site, full service facility complete with water, sewer and electric hookups within three miles of the private facility. With standard Forest Service pricing, the public campground is likely to lead to severe financial consequences for the commercial operator, jeopardize an SBA guaranteed loan and cause unnecessary losses to the American taxpayer, reduce the

number of private sector jobs and lower the tax revenues that could be generated from private operations.

In the Black Hills of South Dakota, the Forest Service again announced its intentions to add full service commercial-style RV hookups in its existing campgrounds. A conservative estimate of lost revenue to the private sector in the immediate area is some $30,000, a substantial amount when you consider the size and length of season of commercial operations.

In California, the National Park Service worked out an arrangement with Caltrans to assume responsibility for a stretch of coastal area known as the Fresh Water Lagoon Spit. As a result, hundreds of campers reside free of charge for weeks at a time along a national park seashore area. The details of this situation will be discussed inlater testimony by individuals directly associated with the results of this situation.

The city of Vassar, Michigan proposed to build a commercial-style campground that would likely reduce private sector revenues by an estimated $25,000 during a three month season. The city has not prepared a business plan or market projections and seeks to saddle the taxpayer with the maintenance and upkeep of a facility that may not be needed by anyone. Many public entities, ranging from the federal government to cities and counties, operate facilities that are too small and uneconomical under any conditions.

The state of Connecticut proposes a 12% tax on transient RV and camping sites and the state's attorney general advises that state park are not subject to the tax, immediately placing the private sector at an increased price disadvantage.

The most flagrant unfair competitive factor is the underpricing of services in the public sector. Because of fee legislation that governs the public sector, because of huge budgets which provide year round personnel, maintenance and construction, because of an absence of land costs and capital acquisition costs, and because of a disregard for business economics and the general taxpayer, public facilities charge fees far below that which is

necessary for economic operations. With no profit motive and no need to justify costs in an economic sense, public sector campgrounds essentially give away the service.

The effect of this tremendous underpricing of services has been to retard the growth of private campground and RV park businesses thereby depriving the consumer of improved facilities and the benefits of the increased tax base that accompanies improved business conditions. Underpricing forces nearby and competitive private facilities to try to come close to matching public sector prices in order to attract business. Underpricing leads to unprofitable businesses that cannot create new jobs and, in fact, leads to failures that cost jobs and tax revenues.

Compounding the problems created by pricing inequities is the fact that public lands are often the most desirable. They offer the most majestic scenery, the outstanding cultural, historic and natural points of interest, and wonderful access to recreational facilities for all manner of activities. All of this and rock bottom prices that are almost too good to believe.

The National Association of RV Parks and Campgrounds has identified eighteen specific competitive advantages enjoyed by the public sector in operating RV parks and campgrounds. This list follows:

1. Below market pricing with operational losses subsidized by general tax revenues or park admission fees.

2. The public sector has no land acquisition costs, mortgages or leases that are factored into the economic viability of the facility.

3. Public sector entities are exempt from real estate and property taxes (although, in some instances, agencies make certain payments to local jurisdictions in lieu of taxes).

4. Frequently, public agencies are exempt from charging or collecting applicable sales or occupancy taxes.

5. There is no motivation to earn a profit (and those operations that might earn a profit are exempt from paying income taxes on the profits).

6. The availability of year round employees who can be assigned and reassigned as duties require is a great advantage to public agencies.

7. Public lands occupy prime scenic land often with access and control of river or lake frontage otherwise not available to the private sector.

8. Access to highway signage opportunities not available to the private sector or available only at very high cost are typically available to public entities.

9. The public sector enjoys access to volunteer labor.

10. the public sector uses tax dollars to self-insure or are subject to reduced liability exposure.

11. State and federal agencies have access to publicly funded travel and tourism promotion dollars and resources.

12. The public sector can function as a large company utilizing nationwide 800 numbers and national reservation systems, detailing employees where needed and enjoy the support of a vast public administrative bureaucracy.

13. The public sector gives away services such as showers and dump station facilities to the consumer.

14. The public sector enjoys media access via public service announcements and use of recognizable public officials in advertising.

15. The public sector provides large discounts to seniors and other special groups without regard for economic impact.

16. The public sector enjoys the ability to accept charitable donations to help cover operating costs, maintenance or capital improvements.

17. Access to corporate grants and foundation gifts is limited to public or non-profit entities.

18. The public sector can float bonds to raise capital and cover costs.

Given all of these concerns, it is the issue of below market pricing and the public sector's lack of interest in operating facilities on an economic basis that cause us the greatest concern.

In this time of huge government deficits and budget squeezes at every level, it is simply incomprehensible to us why government feels compelled to provide subsidized, full service amenity camping facilities for the public, both domestic and international. There is no regard for the financial viability of the facilities nor is there any need for public officials to justify actions based on business-like market studies and business plans.

We frequently hear from public officials that the public demands improved camping facilities with improved amenities. No doubt the public prefers more developed campgrounds with clean, modern facilities of all kinds. But does the same public demand to pay a fair price for the facility? If the public were to price their services at fair market value or at a fair charge to operate economically, the private sector could compete with little difficulty. The problem exists primarily when public agencies offer services comparable to those in the private sector at far lower prices.

Let me turn now briefly to our proposals for correcting a situation we find to be insensitive to small business and the taxpayer's general interests.

First, I am pleased to advise the committee that our association is seeking to work cooperatively with the various federal land management agencies to create a Public-Private Task Force on Unfair Competition to devise ways to avoid future direct situations of unfair competition, to find ways to mitigate the damage done to the private sector through public operation of unfairly competitive facilities and to seek ways to avoid conflicts in the future. We invite you, Mr. Chairman, and members of this committee to join the Task Force personally or through staff participation and to assist federal agencies and the private sector to seek ways to mitigate problems and work cooperatively.

Second, prior to development of new campground facilities, or prior to the upgrading or improvement of existing camping sites, we propose that federal agencies be required to conduct an economic impact study to ascertain how the proposed development or upgrading

is likely to impact existing private sector facilities. The study should be published and distributed broadly and specifically to those private sector businesses and citizens in the geographic area likely to be affected prior to final public sector decision making.

This economic impact statement should take into account the impact on existing private sector business, the financial viability of the proposed program or project in economic terms, the cost to the taxpayer of operation of the program or project, the impact on tax revenue generation and the effect on private sector job opportunities.

Third, we advocate that the GAO undertake a study of all federal activity that has the likelihood of competing with private sector enterprise to determine appropriate legislative remedies to correct the situation.

Fourth, federal funds should not be budgeted for construction of new facilities or for development of new or duplicative services to be owned and operated by the public sector.

Fifth, legislation to assure competitive pricing keyed to market rates in the area is worthy of close study. In setting prices, facilities, amenities and special features (such as location, water frontage, natural scenic beauty, etc.) should be considered.

The public sector should focus its attention and resources on non-economic recreation such as the operation of trails for various recreational pursuits, wilderness facilities, wildlife protection and propagation, public fishing areas, playing fields and picnic areas.

Campground operations on public lands should be contracted, concessioned or permitted to private sector business. If no private sector operator for a particular facility can be found, it might then be appropriate for the public sector to operate the facility, provided it is operated on the same basis as it was originally made available for private sector operation.

Finally, public facilities should charge fees for all camping-related services rendered to the public in the same manner as fees

are charged for other accommodations.

Thank you for this opportunity to present our views and we look forward to working with the committee and the Congress to address the inequities we believe exist.

unfair.text

STATEMENT OF FRANK L. JENSEN, JR., PRESIDENT

HELICOPTER ASSOCIATION INTERNATIONAL

HEARING ON

UNFAIR COMPETITION AND ITS IMPACT ON SMALL BUSINESS

BEFORE THE

HOUSE COMMITTEE ON SMALL BUSINESS,

SUBCOMMITTEE ON PROCUREMENT,

TAXATION AND TOURISM

MAY 11, 1993

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May 11, 1993

Statement of
Frank L. Jensen, Jr., President,
Helicopter Association International
before the House Committee on Small Business,
Subcommittee on Procurement, Taxation and Tourism
on

UNFAIR COMPETITION AND ITS IMPACT ON SMALL BUSINESS

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to appear before you today and discuss an issue of mounting concern to the small business community, unfair government competition. I am Frank L. Jensen, Jr., President of the Helicopter Association International (HAI). For the past forty-five years, the HAI has dedicated itself to the promotion of the safe operation of civil helicopters. Our members operate helicopters in the fields of aerial applications, fire control, Emergency Medical Services (EMS), corporate transport, and aerial sightseeing among many other uses, flying over 4,000 helicopters more than 2 million hours annually. The majority of HAI operators are small business, with over 75% operating less than 5 helicopters.

HAI members are, unfortunately, very familiar with the issue of unfair government competition. As commercial helicopter operators offer for hire an asset which is commonly also operated by many governmental agencies, the potential for encroachment is always present. HAI believes strongly that the appropriate role for the government is to govern and that any commercial activity should be left to the private sector. In David Osborne and Ted Gaebler's bestseller, "Reinventing Government", this principle is re-enforced through a quote by E.S. Savas, chairman of the Department of Management at City University of New York:

> **"The word government is from a Greek word, which means 'to steer'. The job of government is to steer, not row the boat. Delivering services is rowing, and government is not very good at rowing." (p.25)**

HAI could not agree more.

Over the years, there have been several attempts at establishing a national policy of reliance on the private sector. The current attempt is expressed in OMB Circular A-76, which establishes Federal policy regarding the performance of commercial activities and sets forth procedures for determining whether commercial activities should be performed under contract with commercial sources or in-house using government facilities and personnel. But HAI believes that Circular A-76 has failed to produce complete results because it is not perceived as a national priority, either within the government or the private sector. If Congress agrees with the Clinton Administration's assertion that a healthy small business sector is crucial to economic recovery and deficit reduction, the problem of unfair competition by both government and non-profits must be closely monitored. As a member of the Small Business Legislative Council (SBLC), HAI joins with 100 other small business trade associations in calling for the establishment of a national policy on contracting out, which is stable and understandable, endorsed and supported by both the legislative and executive branch.
HAI commends this subcommittee for its willingness to examine the tough issue of unfair government competition and encroachment issues which currently exist, and we hope that our testimony will highlight the need for such a policy.

PUBLIC AIRCRAFT: UNLEVEL PLAYING FIELD

In recent years, budget cutbacks have encouraged many public agencies to explore utilizing their government aircraft to perform commercial services in an attempt to generate additional revenue and/or justify their resources. These government aircraft, because of their classification as "public aircraft", do not have to adhere to Federal Aviation Regulations, in terms of aircraft certification, continuing airworthiness requirements, or pilot licensing requirements such as competency/currency/crew and duty times, all of which are required by the Federal Aviation Administration of commercial for-hire operators for safety reasons . The Senate Committee On Governmental Affairs, Subcommittee on General Services, Federalism and the District of Columbia, chaired by Senator Jim Sasser, recently completed a twenty month investigation into the management of federal civilian aircraft (see Attachment 1). This report, which has been transmitted to the White House, confirms that "there are no authoritative requirements for federal civilian aircraft safety, despite very specific statutory safety requirements for commercial aircraft."

Unburdened by the cost of compliance with both aviation and small business regulations, the use of government aircraft appears to present an attractive option for cash-strapped governmental agencies when a commercial job is being considered. The true cost to the taxpayers of conducting these operations, including not only direct and indirect costs, but also loss of tax revenue and job base, are almost never accurately depicted. To allow a public aircraft to operate outside its governmental mission is not an efficient use of tax dollars. In many instances, these government entities constitute virtual monopolies which would not be permitted in the private sector. HAI believes that, in most situations, the private sector operator could provide the service more efficiently and safely than their public sector counterparts.

UNFAIR COMPETITION: 3 CASE STUDIES

The areas of most concern to the HAI membership in terms of government encroachment into the private sector include the following:

- Improper use of Federal Excess Personal Property (FEPP) surplus military helicopters "loaned" to state foresters by the United States Forest Service
- Use of Florida Department of Forestry excess military UH-1H aircraft to perform long term FEMA non-emergency hurricane relief contract work, when commercial assets are available.
- Use of National Guard aircraft to perform commercial functions, such as movie work and passenger transport, and as most recently illustrated in their bid to remove the statue on the U.S Capitol for refurbishment.

USE OF FEDERAL EXCESS PROPERTY BY USFS BURDENS SMALL BUSINESS

In 1988, the U.S. Army Aviation Systems Command (AVSCOM) announced plans to retire over 6,000 of what its press release termed its "oldest and worst" aircraft over the course of 18 years to make room for newer helicopters. The majority of these 30-year old aircraft are UH-1H models ("Hueys") procured and used during the Vietnam war. These helicopters, stripped of all military equipment, are either sold under the foreign military sales umbrella, or labeled "excess" and offered to other government agencies.

Many of these excess helicopters are then distributed, through a federal agency, into the hands of state agencies. Such is the scenario with the United States Forest Service (USFS) which, under the Federal Property and Administrative Services Act, loans these "free" excess aircraft to state foresters, such as the California Department of Forestry (CDF). These state programs must assure the General Services Administration (GSA), which has oversight over the Federal Excess Personal Property (FEPP) program, that the assets are being acquired for the internal use of that state to fulfill a state's mission, as required by the Act.

In California, small business helicopter operators have a cause for concern. In 1981, the California Department of Forestry (CDF) negotiated a 10-year lease for nine UH-1F helicopters from the Air Force. In response to private sector concerns over the transaction, CDF assured the operators that none of the seven firefighting contracts currently held would be affected. Thirty days prior to the renewal of these contracts, the CDF abruptly canceled six of the seven helicopter contracts. One operator estimated the loss of between $10 and $15 million due to the cancellation of the three-year contracts.

The CDF has since replaced these aircraft with FEPP EH-1H helicopters. Not only does this suggest more erosion of fire contracts, but, in addition, the refurbishment of these "free" helicopters is costing California taxpayers a small fortune. In an article which appeared in the Wall Street Journal (June 19, 1990), refurbishment costs for these "free" helicopters has been estimated at upwards of $850,000 per aircraft.

In the past, the government has contracted out to commercial helicopter operators for all aerial firefighting services. On the federal level, the Forest Service does not feel it is economically feasible to operate its own fleet, and relies solely on the private sector, with its experienced pilots and certificated, insured equipment, to fill its needs. The excess helicopter program, however, gives each state the opportunity to create its own aviation department, with little thought to whether this is indeed more economical than contracting out (see Attachment 2).

Despite the Federal Property and Administrative Services Act's requirement that the excess property be acquired for internal use only, in this case to put out fires on state land, the operators have witnessed the CDF using these resources on federal fires, and requesting reimbursement from the USFS for their services. This places them in direct competition with commercial operators, and in violation of the provisions of Federal Aviation Regulations Part 135.

A particularly onerous example involves the use of a San Bernandino County Sheriff's helicopter, acquired through the FEPP program for law enforcement. The Sheriff's Office leases the aircraft to the CDF for fire protection, and is reimbursed for its services. HAI recognized that such activity was clearly "commercial" in nature, and would not be covered by the "public aircraft" umbrella. FAA Assistant Chief Counsel Donald Byrne in a March 10 letter to HAI agreed, stating that, "Governmental entities operating for compensation or hire are subject to all the same regulations that apply to non-governmental entities conducting similar operations" (see Attachment 3). HAI intends to use this determination to highlight this example of unfair competition.

Mr. Chairman, with the continued downsizing of the military, HAI anticipates that you will be hearing from other sectors of the small business community on inappropriate uses of Federal Excess Personal Property.

HAI recommends to the Subcommittee that

1) the General Services Administration, which has oversight over the FEPP program, be required to ensure that any federal or state agency which acquires the property continues to use it exclusively for their internal use, and does not use the property to compete with the private sector,

2) that the Forest Service, which has the transfer power for these aircraft, be required to adhere to the guidelines of the Federal Property and Administrative Services Act, and encourage the state foresters to use the FEPP aircraft only on state business, and

3) that OMB A-76/A-126 studies be conducted by the agencies which utilize FEPP aircraft which would give an accurate comparison between the cost of an in house fleet versus contracting out for aviation services.

FEMA: LONGTERM DISASTER RELIEF BELONGS WITH PRIVATE SECTOR

The Federal Emergency Management Agency (FEMA) has a strict policy of utilizing commercial assets whenever possible. In the aftermath of Hurricane Hugo, a situation has arisen that conflicts with this principle.

The State of Florida Division of Forestry (FDF) has been given an 8-10 month contract to remove debris from federal, state, and private lands. The reimbursement is part of a federal grant provided to the state for disaster relief. The helicopters of choice are two UH-1H excess FEPP helicopters, which were acquired solely for the use of the Florida Division of Forestry. There are many commercial operators available to perform the same mission. Again, the FDF aircraft are uncertificated and are performing services under the "public aircraft" definition. without proper FAA certification. One operator in the area has requested that the FAA investigate this operation as illegal under the Federal Aviation Regulations.

As this is a non-emergency long term contract, there is no reason why the job could not be contracted out to the commercial sector. **Again, proper oversight of the FEPP aircraft and FAA enforcement of regulations would end this unfair competition by these state agencies.**

STATUE OF FREEDOM: NATIONAL GUARD VS. PRIVATE SECTOR

On May 9, Erickson Air-Crane, a small company from Oregon, lifted the Statue of Freedom off the Capitol Dome for cleaning and repairs. The actual operation went very smoothly, considering the intense controversy that had preceded it.

An article in Roll Call several weeks ago revealed that the Mississippi, Alabama, and Pennsylvania National Guard units had been training for months to perform this precision heavy lift. HAI then protested that this is purely a commercial function and that the private sector is more qualified to do the job (see Attachment 4, letter to Secretary of Defense Les Aspin). The Defense Department agreed that the job more appropriately belonged to the private sector. Deputy Defense Secretary William J. Perry, in a letter to Architect of the Capitol George White, said the Defense Department has a policy against competing with private industry. Perry stated that "while the National Guard is certainly capable of accomplishing your mission, the clear intent of both the Executive Branch and Congress is that competition with commercial industry be avoided."

The National Guard, for the most part, follows this principle. Problems have arisen though with state Guard units, who can term a commercial mission "training" and unfairly compete with the private sector. When this subterfuge of "training" is used, a "lose/lose" situation is created. Firstly, the legitimate training curriculum is not being followed, and secondly, the taxpayer is footing the bill for a job that should be done more economically under a private sector contract.

One such example involved a North Carolina operator who was hired to perform a job for Allied-Signal Corporation, a private firm. The job was to test new radar equipment installed at Raleigh Durham International Airport, to verify its integrity during simultaneous approaches to parallel runways. A few days later, the operator received a phone call from Allied-Signal informing him that the National Guard had volunteered their services for the job. Needless to say, the operator lost out on nearly $1100.00 of revenue, which is significant for a small firm. Another "lose/lose" situation.

Another incident occurred when a public utility company was looking for a helicopter to move two heavy loads from 5,000 ft. to 7,400 ft. The roads were closed because of snow and a helicopter seemed like the most logical solution. The manager checked with some helicopter operators in the area, who agreed to do the job for $7800 an hour, the going rate for a Chinook helicopter. Unfortunately, the helicopter would not be available for another week. A person on the scene then called the National Guard, who recommended an Army NG CH-47D to do the job for a quote of $3000. The manager checked with his Legal Department which told him that the Guard could not legally work for a private company. When the Guard was turned down for the job, they offered an $1800 an hour counteroffer! The company still refused.

All requests for use of National Guard assets must go through the National Guard Bureau in Washington. The Bureau has strongly defended its policy that its assets should only be used in accordance with its mission to " maintain combat ready forces and conduct federal peacetime engagement operations as dictated by the President and Congress". But the decentralized nature of the force makes it difficult to control the use of assets. Small businesses are the ones who are forced to combat Goliath, and usually the situation doesn't fall in their favor.

The HAI recommends that the National Guard Bureau be asked to enforce the use of National Guard assets for only those missions which appropriately fit into the mission statement of the Guard, and are not in conflict with those services available by the commercial sector. Further, everyone in the chain of command must be strongly discouraged from using the specious justification of "training" to rationalize performance of otherwise unauthorized services.

CONCLUSION

The HAI applauds and respects the fine work done by federal agencies in performance of their governmental function. Many of our members received helicopter flight training from the military and still contribute to the defense of this country through service in the National Guard and Reserve components. The role of these agencies are appropriate and necessary.

The House Small Business Subcommittee of Procurement, Taxation and Tourism needs to recognize that, especially with the upcoming base closures and defense downsizing, more federal agencies will be looking for additional ways of justifying their resources to the American taxpayers. The line between public and private sector needs to be clearly defined by those proponents of small business, or the experience of the civil helicopter industry will be repeated in many different industries. As the Clinton Administration "reinvents government", HAI calls for this subcommittee to recognize the importance of preserving the marketplace for the private sector and to protect the private sector from government encroachment.

Attachment 1

JOHN GLENN, OHIO, CHAIRMAN
SAM NUNN, GEORGIA
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FRANKLIN G. POLK, MINORITY STAFF DIRECTOR AND CHIEF COUNSEL

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

April 2, 1993

Honorable Bill Clinton
President of the United States
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

I am writing to commend your efforts to better manage the federal government's civilian aircraft and to offer my assistance in this endeavor. As Chairman of the Subcommittee on General Services, Federalism and the District of Columbia, I am pleased to present you with this report, "Management of Federal Civilian Aircraft: Findings and Recommendations," based on a twenty month investigation initiated in August of 1991.

As you recall, on February 10 you directed the heads of federal agencies and departments to ensure all aircraft under their control are used only for government purposes and in keeping with OMB Circular A-126. I applaud your leadership — and in an effort to expedite meaningful reform, my subcommittee has prepared this report outlining the problems with aircraft management and offering a blueprint for reform.

I have found that the government runs a billion-dollar aircraft operation that is substantially out of control. Federal civilian aircraft are worth over one billion dollars, and they cost well over one billion dollars each year to operate. Yet the use of these aircraft has gone essentially unscrutinized. For example:

- At the outset of my investigation, the General Services Administration (GSA) and the Office of Management and Budget (OMB), the agencies responsible for aircraft management, did not even know how many aircraft government agencies owned, much less where they were and how they were used. An audit by the GSA Inspector General, now in progress at my request, indicates there are now 1,384 aircraft in the inventory but we still do not know how they are used.

- There are no binding safety standards for federal civilian aircraft. Literally, air pilot licenses and routine safety and maintenance checks are not required by law. Private aircraft are subject to broad, strict, government-imposed safety regulations, but the government's own aircraft are exempt.

- Agencies' inventory and usage reports required by Circular A-126 are often late, inaccurate or incomplete. Only last January aircraft managers had to request computerized submissions because past submissions were illegible. The annual inventory for fiscal year 1991 was not completed until months into fiscal year 1993.

- Agencies appear to be flouting Circular A-126. They have contrived technical, legalistic interpretations of the circular to allow the most lenient possible standards. In an effort to avoid scrutiny, agencies have classified aircraft capable of administrative travel use as "mission" aircraft supposedly performing some special government function.

- Over 185 aircraft owned by the government are flown less than 100 hours per year.

- Neither OMB nor GSA have acted to enforce Circular A-126, even though they know deficiencies exist. These agencies claim not to have the authority or the duty to enforce their own policies.

The net result of these and the other abuses chronicled in my report is a loss to the taxpayers of at least $100 million. In fact, I believe that the Inspector General's audit will reveal inefficiencies totalling half a billion dollars or more.

I have offered a number of recommendations which I believe will go a long way to ameliorate the problems with government aircraft management. I hope you will review these recommendations and implement them in the manner you deem most appropriate. Most of my recommendations can be implemented administratively — however, I am also prepared to lead the Congressional response to the inefficient management of government aircraft by taking any legislative action necessary.

I look forward to working with you to resolve the problems outlined in my report. I plan to remain active on this issue for as long as is necessary. Thank you for assisting me in making the Executive Branch more accountable to the taxpayer in the use of its aircraft.

Sincerely,

Jim Sasser
Chairman
Subcommittee on General Services,
Federalism and the District of Columbia

Attachment 2 -

PRAGMA, INC.

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FACT SHEET

"H" MODEL HELICOPTER PROGRAM

COSTS AND BENEFITS OF PRIVATE CONTRACTING

The debate over the privatization of government services is at an all time high. Whether government can and should be in the business of competing with private industry for duplicative services, and whether the public is getting fair value for the dollars spent is the subject of controversy.

The current recession has been especially acute in California. Economic forecasters predict that California will not rebound as quickly as the rest of the country. The state is losing small businesses, the source of over fifty percent of private sector employment, at a much faster rate than most other states. The governor has declared that his administration will make every effort to create a climate in which small businesses can prosper. However, the reality is that the public sector continues to grow and the private sector continues to shrink.

The California Department of Forestry and Fire Protection is in direct competition with twenty-nine commercial helicopter operators to provide air attack services for wildland fires. A report has been compiled to demonstrate that significant savings and increased public safety can be accomplished by utilizing the commercial helicopter operators.

The report uses data available from public records to enhance the budgetary figures provided by CDF. In some cases, actual costs are not available and are not included. However, in all instances, using conservative estimates, the private operators can provide service for a 36% to 41% savings, while the costs for the CDF program have more than doubled from a $2 million estimate to an actual cost of over $5 million annually.

The "H" model helicopter operations budget provides a realistic and graphic comparison of the savings available to the State of California by utilizing private contractors for wildland fire suppression. Using the average fire year operations of 250 hours, the per hour costs for CDF aircraft is $2533. The private contractor can provide the same service at a cost of $1490 per hour. The total annual cost of the "H" model program for 1993 with CDF helicopters will be approximately $5,066,142; the cost of private sector service would be $2,979,998, a savings of $2,086,144 in the "H" model program alone.

Savings should not be the only criteria by which a program is judged. Efficiency of operations and public safety are important factors to be considered. A major concern regarding the CDF air operations is the question of the airworthiness of their helicopters and the proficiency ratings of their pilots. Commercial operators must have their aircraft, their mechanics and their pilots Federal Aviation Administration (FAA) certified CDF is self certified for aircraft, mechanics, and pilots.

CDF modifies twenty-four year old helicopters surplused from the federal government. Because CDF certifies its own modifications and engine maintenance, no independent source can verify whether the modifications meet FAA standards or exceed design parameters. Commercial operators must submit modification designs to the FAA for conceptual approval in advance of any structural changes. Once the FAA approves the modification design, they inspect and flight test the modified craft before it can be certified.

The same is true for the pilots. CDF pilots are self certified; commercial pilots are FAA certified. Commercial operators use their craft and pilots on a year round basis. Commercial pilots average four to six hundred flight hours per year. They are current on all FAA requirements. CDF pilots fly on an intermittent, as needed, basis. There is no independent verification that CDF meets necessary standards of safety or readiness.

The commercial helicopter operators believe that, using CDF's own data, the case is made in favor of the private sector for lower costs of operations and public safety.

Attachment 3

U.S Department
of Transportation
Federal Aviation
Administration

800 Independence Ave S.W
Washington, D.C. 2059[illegible]

[illegible] 0 1993

Frank L. Jensen, Jr.
President
Helicopter Association International
1619 Duke Street
Alexandria, Virginia 22314-3439

Dear Mr. Jensen:

This is in response to your letter, dated January 7, to Art Jacobson of this office. Your letter refers to what you see as a trend toward the use of government-owned aircraft for compensation or hire without appropriate certification by the Federal Aviation Administration (FAA). You refer specifically to the San Bernardino Sheriff's Department contracting out aircraft it owns to the State of California, and to a proposal that the State of Maryland charge for use of its Med-Evac helicopter services. This letter addresses directly the latter issue; see the enclosed letter to Wanda Rogers of Rogers Helicopters in regard to the former issue.

The four enumerated questions set out in your letter are answered as follows.

QUESTION: "How does the FAA define the term 'public aircraft' and under what circumstances is a government entity deemed to be 'engaged in carrying persons or property for commercial purposes', as those terms are used in Section 101 (36) of the Federal Aviation Act?"

ANSWER: The term "public aircraft" is defined, for the FAA and everyone else, by the Federal Aviation Act (FAAct), as amended, as follows:

> "Public aircraft" means an aircraft used exclusively in the service of any government or of any political subdivision thereof including the government of any State, Territory, or possession of the United States, or the District of Columbia, but not including any government-owned aircraft engaged in carrying persons or property for commercial purposes. For purposes of this paragraph, "used exclusively in the service of" means, for other than the Federal Government, an aircraft which is owned and operated by a governmental entity for other than commercial purposes or which is exclusively leased by such governmental entity for not less than 90 continuous days.

FAAct, as amended, Section 101(36).

An aircraft owned by a governmental entity is deemed to be "carrying persons or property for commercial purposes" when the governmental entity is receiving "compensation or hire," as that term has been interpreted, for the use of its aircraft. Thus, as set out in the enclosed letter to Ms. Rogers, receipt of payment by the San Bernardino Sheriff's Office for the use of its aircraft by the State of California means the aircraft cannot be a public aircraft of the sheriff's office while it is being operated by the state. If the State of Maryland charges for use of its helicopters, those helicopters will not be public aircraft for as long as that arrangement is in effect. Charges for medical services provided while en route to a hospital that are not adjusted in any way to include the cost of operating the helicopters do not affect the public aircraft status of the aircraft involved.

A governmental entity operating an aircraft for commercial purposes is subject to all the regulations that apply to any operator conducting a similar operation for compensation or hire.

QUESTION: "To what extent and on what basis is a 'public aircraft' operator exempt from Part 91 regulations?"

ANSWER: The operator of a public aircraft is exempt from those regulations in Part 91 that are specifically limited by their terms to the operators of "civil aircraft." Other regulations, applicable by their terms to "aircraft" without apparent limitation, may nevertheless be inapplicable to "public aircraft" if the context of the regulations so requires.

QUESTION: "To what extent and on what basis is a government entity operating for commercial purposes and/or for compensation or hire exempt from complying with other Federal Aviation Regulations, including Parts 133 and 135?"

ANSWER: Governmental entities operating for compensation or hire are subject to all the same regulations that apply to non-governmental entities conducting similar operations.

QUESTION: "If a 'public aircraft' operator possesses a valid airworthiness certificate issued by the FAA, what are the continuing airworthiness responsibilities of that operator? Under what circumstances can the FAA revoke that airworthiness certificate?"

ANSWER: The operator is responsible for operating in accordance with those regulations that apply to the operation because they are not limited by their terms or by implications arising from context to "civil aircraft" only. If, however, the operator wishes to retain a standard airworthiness

certificate for an aircraft the operator must maintain the aircraft in accordance with Parts 43 and 91 of the Federal Aviation Regulations. If the operator fails to do so the certificate is no longer effective, by operation of law, and the FAA may demand its surrender to avoid any possibility that the traveling public could be mislead by the operator's continued possession of the certificate.

Thank you for your continued interest in these matters.

Donald P. Byrne
Assistant Chief Counsel
Regulations Division

Enclosure

U.S. Department
of Transportation
Federal Aviation
Administration

800 Independence Ave., S.W.
Washington, D.C. 20591

APR 28 1993

Ms. Wanda L. Rogers
President
Rogers Helicopters, Inc.
P.O. Box 4
Clovis, CA 93613

Dear Ms. Rogers:

This letter is in response to your letter to the Administrator of the Federal Aviation Administration (FAA), dated December 3, 1992, and to the letter from Floyd Hiser enclosed therewith. It also has reference to your letter of that same date to the FAA's Fresno, California Flight Standards District Office, and to other documents as noted. Copies of all referenced documents are enclosed.

We have reviewed Mr. Hiser's letter and the legal authorities to which it refers. None of those authorities supports your contention that otherwise civil aircraft operating under contract to governmental entities can never be public aircraft within the meaning of the Federal Aviation Act (FAAct) and the Federal Aviation Regulations (FAR). A more significant case in this regard is United States v. Aero Spacelines, Inc., 361 F.2d 916 (9th Cir. 1966), in which the court held that aircraft on lease to the National Aeronautics and Space Administration for its exclusive use for an extended period of time were public aircraft within the meaning of the statute.

That case, however, is not dispositive of the situation of which you complain. The statutory definition of public aircraft, which is the basis for legal analysis of the issues you raise, has been amended significantly since the Aero Spacelines case was decided. The definition now reads as follows:

> "Public aircraft" means an aircraft used exclusively in the service of any government or of any political subdivision thereof including the government of any State, Territory, or possession of the United States, or the District of Columbia, but not including any government-owned aircraft engaged in carrying persons or property for commercial purposes. For purposes of this paragraph, "used exclusively in the service of" means, for other than the

> Federal Government, an aircraft which is owned and operated by a governmental entity for other than commercial purposes or which is exclusively leased by such governmental entity for not less than 90 continuous days.

FAAct, as amended, Section 101(36) (new language underscored).

The basic concept involved in providing for a class of public aircraft that are exempt from many of the statutory and regulatory requirements that apply to aircraft generally is that aircraft operated by governmental agencies are not in need of regulation by another governmental agency. Further, it goes without saying that a governmental agency, like any other operator, will be responsible for any damages or injuries caused by aircraft it operates. The situation you have brought to our attention is unusual in that it involves three governmental agencies, one local, one state, and one federal. Analyzing the relationships among those three governmental agencies, as they relate to the aircraft involved, under this definition leads us to conclude that the aircraft are not public aircraft while under lease to the State of California Department of Forestry and Fire Protection. Although the documentation we have does not necessarily provide a complete and comprehensive description of the interrelationships among those governments, it is sufficient for us to conclude that no set of facts can be established that would make the operations involved public aircraft operations within the meaning of the FAAct.

The aircraft are owned by the San Bernardino Sheriff's Office and are presumptively public aircraft while being used for that agency's lawful purposes. When the Sheriff's Office leases the aircraft, however, the aircraft are "engaged in carrying persons or property for commercial purposes" within the meaning of the statutory definition. The FAA has consistently interpreted using aircraft for "commercial purposes" in this context to be equivalent to receiving "compensation or hire" for the use of the aircraft. It is possible for an aircraft owned by a non-governmental party to become a public aircraft under a lease to a governmental agency, as determined in the Aero Spacelines case. Nothing in the statutory definition prohibits that result. When a governmental owner leases its aircraft, however, the statutory limitation takes effect and the aircraft cannot be a public aircraft of that agency.

Because the lease in this case is to another governmental agency, however, that conclusion does not end the inquiry. The court's holding in the Aero Spacelines case raises a question whether the aircraft involved here could be considered public aircraft because they are on lease to a governmental agency and are presumably used exclusively in the service of that agency during the lease period. Under the statute, as amended since the decision in that case, an aircraft on lease to a state agency can be a public aircraft of that agency only if the lease is exclusive, and continuous for at least 90 days. Since that is obviously not the case here, the aircraft cannot be considered public aircraft of the State of California.

We have examined also whether the aircraft can be considered public aircraft of the United States Department of Agriculture Forestry Service (USDA) during the times they are on lease to the State of California. According to an April 30, 1991, USDA memorandum provided to us, the USDA reimburses the state for the costs of the aircraft leased from the Sheriff's Office, and exercises at least some control over the aircrafts' use by the state through a joint USDA/state aircraft management program. A State of California memorandum provided to us shows, however, that the state exercises extensive control over when and where the leased aircraft are to be used. The state may assign the aircraft to either search and rescue or fire suppression at its discretion, and retains the right to release the aircraft back to the Sheriff's Office even during a fire incident should that release be in the economic interest of the state. Furthermore, the contract between the state and the Sheriff's Office clearly establishes that the USDA plays no exclusive role in the use of the aircraft under the lease. It is clear that the state is in charge of operations under the lease. We conclude, therefore, that the aircraft are not used exclusively in service of the USDA, and cannot be public aircraft of that agency.

Finally, we note that the contract between the state and the Sheriff's Office provides, in paragraph F.1., that:

> "Non-Certificated Aircraft shall be operated as Public Aircraft"; and, a COUNTY letter to that effect will be filed with FAA, with a copy to be carried aboard each aircraft.

This provision of the contract has no legal significance. Whether an aircraft is a public aircraft is a matter of law. The law as we see it is clear. Aircraft used under this lease arrangement are civil aircraft. Non-certificated aircraft belonging to the Sheriff that are used by the state under this lease arrangement are subject to enforcement action by the FAA.

Sincerely,

John H. Cassady
Acting Chief Counsel

Enclosures

Attachment 4

1619 Duke Street Alexandria Virginia 22314-3439 Telephone: 703/683-4646 Fax: 703/683-4745 Telex: 89-615

April 6, 1993

The Honorable Les Aspin
Secretary of Defense
Washington, DC 20301-1000

Dear Secretary Aspin:

The "Operation Liftoff" article in the March 29, 1993 issue of ROLL CALL, (Enclosure 1), describes a matter which deserves your personal attention. At issue is whether National Guard helicopters, not designed or intended for this type of lift, should be used in preference to private sector helicopters, which are so designed, and are used regularly for precision heavy lifting. You have been asked by the Architect of the Capitol to approve the use of National Guard helicopters for this job.

In addition to the suitability of the helicopters available to the National Guard, there is the question of cost. For the private sector, using a top-of-the line heavy-lift helicopter, with specialized crews, the total cost, including liability insurance, is $60,000. Based on information that I have received from both the Office of Architect of the Capitol, and from your Department, the real costs of having the job done by the National Guard will cost the taxpayers many times that amount.

As a retired U.S. Army aviator, I have the greatest respect for my fellow aviators in the active-duty and reserve military, including the National Guard. However, for whatever reason, the National Guard does not have, to my knowledge, a helicopter as well suited to this particular task as those available in the private sector.

Reportedly, some elements of the National Guard have lobbied intensively for this mission. I have been told that Guard units from Alabama, Mississippi and Pennsylvania, have established a joint training site in Mississippi, and have built, or are building, a simulated dome and statue to facilitate practicing for this lift. The type of aircraft used would be the CH-47D, which is billed at $6,709 per hour for non-DOD users. Even if there were no other costs, just the ferry time of the CH-47D's to the practice site would cost more than the $60,000 that the total effort would cost if done by the private sector. The rationalization that these expenses can be justified as training is specious.

In view of the foregoing, it is urged that you not approve the use of National Guard helicopters for this job. Further factors for your consideration are enclosed (Enclosure 2). I would be very pleased to provide assistance in this important matter, including the names of properly-equipped, highly-qualified, civil helicopter operators who are prepared to accomplish this task at minimal cost to the taxpayer.

Sincerely,

Frank L. Jensen, Jr.
President

Enclosures: Two (2), as stated
cc: Architect of the Capitol

Enclosure 1

'Operation Liftoff' Set for Early May

Helicopter Still Sought to Remove Statue

By Karen Foerstel

In one of the most spectacular engineering projects ever undertaken in Washington, the 19-foot-tall Statue of Freedom that has stood atop the Capitol Dome since the Civil War is scheduled to be removed by helicopter sometime during the first two weeks of May.

After the statue has been lifted off the Dome, it will be deposited on the East Front Plaza, where it will undergo four months of renovations, the Architect of the Capitol's office said last week.

As early as this week, employees of the Architect are expected to begin erecting scaffolding around the cast-iron pedestal that supports the seven-ton statue more than 250 feet above the ground. While the statue is renovated on the ground beginning in May, work to restore the stand will also be conducted atop the Dome.

The statue will be placed on the East Plaza, where it will be renovated, using walnut shells, among other materials.

Trailers and other equipment for the massive project will begin appearing on the East Front Plaza during the next two weeks.

Once the statue is removed, it will be placed in a fenced-off area of the Senate Plaza where conservators will begin their work. The entire cost of the project is estimated at $750,000. The money has been raised through private donations gathered by the US Capitol Preservation Commission.

Fine Objects Conservation, Inc., a Connecticut firm that worked on the renovation of the Statue of Liberty, has been hired to do the renovations, and experts in iron renovation have been called in from the National Park Service to assist.

A survey of the statue conducted last year revealed that the 130-year old figure was suffering from corrosion and decay.

Conservators plan first to clean the statue of debris by gently blasting it with either water or crushed walnut shells, said Linda Merk-Gould of Fine Objects Conservation.

The bronze statue will then be "chemically repatinated" to bring back its green color (it is currently a muddy shade of brown).

Before being replaced atop the Dome, the statue will receive a coat of special acrylic lacquer to protect it from future corrosion. The lacquer will have to be reapplied regularly, Merk-Gould said.

But it's the airlift itself that will present the most difficult engineering problem. In fact, no decision has yet been made on who will lift the 19-foot, six-inch, 14,985-pound statue off the Dome.

For more than a year now, Architect workers have been meeting with representatives of the military and private companies to determine what type of helicopter should be used.

The Marine Corps, which was approached by the Architect, recently turned down the offer, saying they weren't properly equipped. The Architect is now talking with the National Guard and private firms.

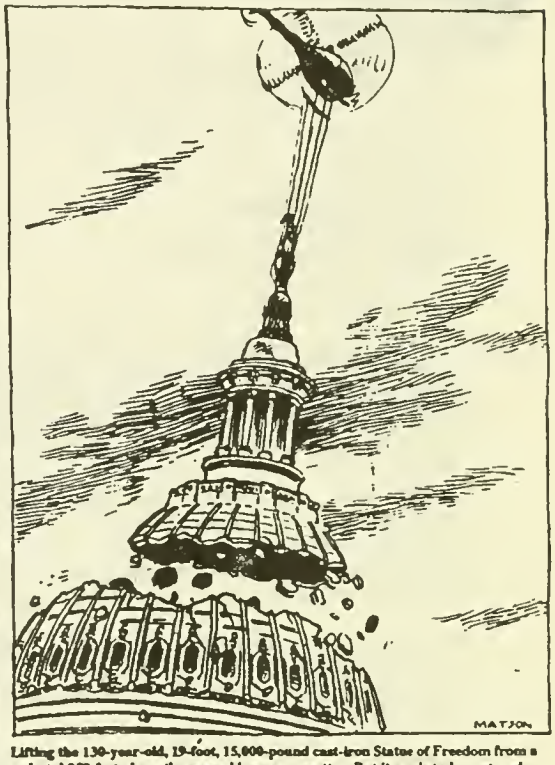
Frank Jensen, a retired military helicopter pilot and president of the Helicopter Association International, told Roll Call last week that he believes a private company should be hired.

"This is the sort of thing many people in the private sector do on a regular basis with heavy-lift helicopters. They're specially trained and certified in this type of thing," Jensen said. "Removing cranes from bridges, from buildings."

It is hoped that the entire project will be completed by September in time for the 200-year anniversary of the Capitol.

The Statue of Freedom was originally set atop the Dome with ropes and pulleys in 1863, but the Architect last year determined that it would be easier to take it down by air.

This will be the first time the statue has ever been removed.



Lifting the 130-year-old, 19-foot, 15,000-pound cast-iron Statue of Freedom from a pedestal 250 feet above the ground is no easy matter. But it needs to be restored.

4 Select Committees Meet Doom Wednesday

By Mary Jacoby

With the four House select committees set to expire on Wednesday, Republican leaders are opposing a short reprieve for the 61 staffers who are about to lose their jobs.

The final decision will come Tuesday, when the House Administration personnel and police subcommittee meets to decide the issue.

House Administration Chairman Charlie Rose (D-NC) said on Thursday that the Clerk of the House "will be given the considerable responsibility of closing out the accounts" and winding up other business of the four select committees — Aging; Children, Youth, and Families; Hunger; and Narcotics Abuse and Control.

However, Rose added that GOP and Democratic leaders would have to agree on the policy before House Administration could direct the Clerk to implement it.

On Friday an aide to Speaker Tom Foley (D-Wash) said, "No decision has been made, but the subject is not closed."

Republican leaders told Rep. Bill Thomas (R-Calif., the ranking member of Ohio), the Hunger chairman (Roll Call, March 8).

A spokeswoman for Thomas, D.J. Nordquist, said Thomas agrees with the GOP leadership position. But Thomas did not specifically voice those objections at Thursday's full House Administration meeting.

Instead, he talked about establishing a procedure for closing up committees.

"This is new and novel. No one knows what to do about shutting down a commit-

Factors for Consideration
Helicopter Liftoff/Replacement of Statue on U.S. Capitol Dome

Types of helicopters available to the National Guard and to the Private Sector

o The largest helicopter in the current inventory of the National Guard is the CH-47D "Chinook". This an excellent troop-support helicopter, well proven through many years of military service, including combat action in Vietnam, Grenada, and Operation Desert Storm. The external-load ("hook") capacity is adequate, depending on density altitude and wind conditions at the time of lift and certain other factors, to accommodate the 17,500 pound reported weight of the statue. However, in the Chinook, both pilots face forward, and cannot see the load they are to handle. They depend on signals from someone on the ground, and/or intercom instructions from a crewman on board.

In November 1985, based on information that I have received, National Guard Chinooks were used to successfully remove the statue from atop the Texas Capitol Dome in Austin. However, in June 1986, according to the same source, after several unsuccessful attempts by National Guard Chinooks to replace the statue, a Mississippi National Guard "Skycrane" was called in to complete the replacement of the statue.

It has been related to me that elements of the National Guard have lobbied for this assignment, which is no doubt viewed as a high-visibility "plum" task. But is it realistic to risk this same high-visibility responsibility on equipment that was not designed, and is not regularly used for this purpose?

Also, I have been told that National Guard units from Alabama, Mississippi and Pennsylvania have chosen to set up a special training facility in Mississippi just for this task, and to build a facsimile of the Capitol Dome, complete with simulated statue, to practice for this job. If this is true, doesn't that indicate cause for concern?

The argument that all of this National Guard preparation comprises training which would be necessary anyway is subject to close scrutiny. The published cost per hour for CH-47D is $6,709 per hour for "non-DOD & other federal users", according to (USACEAC letter dated 4 September 1992, Subject: FY '93 Cost Reimbursement Rates for Army Aircraft). At that rate, it would only take nine and a half hours of either ferry time (one trip from Pennsylvania to Mississippi, or from Mississippi to Washington, DC), to exceed the TOTAL cost of the private sector accomplishment of the job. Further, these Army rates do not include salaries for the personnel, travel pay and per diem, vehicular support, and the many other costs involved. One cost element specifically missing from the National Guard's accounting will be insurance, since these operations are "self insured" by the respective government(s). If any damage is done during a National Guard operation, it is my understanding that settlement of any liability claims must then come from the government involved...again, a hit on the taxpayer.

- The helicopter contractor who has submitted the proposal of $60,000 turn-key for removal and replacement is Erickson Skycrane. They own the type certificate for the S-64F "Skycrane", which was designed for precision heavy lift work. With an external load capacity at least equal to that of the Chinook, the Skycrane is configured so that one or more pilots face forward, and another pilot, with complete controls, sits facing aft, where he/she can clearly see the load as well as control the helicopter.

  The S-64F Skycrane operated by Erickson has a specially-designed four-point external load suspension system, which minimizes the likelihood of the external load twisting or swinging while in transit.

  Please see Erickson Skycrane letter to the Architect of the Capitol, dated April 5, 1993, attached.

Attachment, as stated

STATEMENT OF

GEORGE T. SNYDER, JR.

PRESIDENT AND CEO

OF THE

AMERICAN BUS ASSOCIATION

ON

UNFAIR COMPETITION IN TOURISM AND OTHER RELATED AREAS

BEFORE THE

SUBCOMMITTEE ON PROCUREMENT, TAXATION, AND TOURISM

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

TUESDAY, MAY 11, 1993

2359 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, D.C.

American Bus Association
1015 15th Street, N.W.
Washington, DC 20005
(202) 842-1645

Mr. Chairman and members of the Subcommittee, I am George T. Snyder, Jr., President and CEO of the American Bus Association ("ABA"). ABA represents more than 3,500 companies involved with bus regular route, tour and charter, and airport and commuter services, and in businesses that are related to travel and tourism.

The intercity bus industry provides transportation service to rural and small communities. For many small communities, bus service may be the only means of intercity transportation available. Most passengers of intercity buses are from lower income families. In contrast, most air passengers are from metropolitan areas and relatively higher income families. Amtrak passengers include a significant share of lower income families. These passengers are a key segment of the bus industry's market. The industry's ability to compete with Amtrak for their travel demand is critical to the survivability of the intercity bus industry.

During the past several years, ABA members have faced increasing competition from and lost business to tax-exempt schools, colleges, universities, churches and other groups that provide bus tour and charter service. As tax-exempt organizations, these entities enjoy tax and other advantages unavailable to tax-paying bus companies.

I appear before the Subcommittee today to express ABA's view that federal subsidies to air and train passengers as well as the commercial activity on the part of tax-exempt organizations constitutes unfair competition. ABA submits that when Congressional policy confers tax or other advantages on the competitors of tax-paying bus companies, those bus companies cannot compete as effectively.

The size of the bus industry is impressive. Data gathered from Federal Highway Administration sources indicate that in 1992 there was a total U.S. bus fleet of 631,279. Of this total, only 20,000 were commercial intercity buses. Roughly 356,000 were publicly owned and publicly operated buses, both transit and school. Two Hundred Seventy-four thousand were privately owned, non-commercial buses.

A recent report by Nathan Associates, Inc. sets forth estimates of federal transportation subsidies.[1] The report found that federal subsidies to all other modes of commercial intercity transportation have continued to keep the bus industry at a competitive disadvantage. Between 1960 and 1991, commercial air and rail transportation received subsidies at least 40 times greater than the modest subsidy going to the intercity bus industry. Each passenger trip by bus received a federal subsidy of only 5 cents in the form of a partial exemption from the federal fuel tax.

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[1]"The Impact of Higher Motor Fuel Taxes on the Intercity Bus Industry" Nathan Associates, Inc. February 1993.

In contrast, Amtrak passengers received a subsidy of $54.09 per trip and commercial air carrier passengers received $6.48 per trip. Both air and rail subsidies are in the form of outlays from federal funds and trust funds across federal agencies in addition to Airport and Airway Trust Fund and Highway Trust Fund receipts.

In addition to federally subsidized competition, the industry is plagued by unfair competition.

The competition engaged in by tax-exempt organizations is unfair because: 1) such organizations do not pay federal, state or local taxes; and 2) such entities are exempt from many federal and state safety regulations that apply to private operators. ABA submits that when tax-exempt schools and churches engage in unlawful tour and charter activity, they not only threaten the tax-paying bus industry, but also deprive the state and Federal government of substantial tax revenues. ABA is aware of numerous schools and churches that are engaging in and promoting unlawful tour and charter activities. As many charter operators are small businesses, unfair competition from tax-exempt entities, together with other financial pressures, such as the high cost of liability insurance, is threatening the existence of many of these businesses. It should also be noted that tax-exempt organizations are not required to carry the $5 million liability insurance that is required of tax-paying bus operators.

ABA does not believe that the charter and tour services provided by tax-exempt entities for their own members should be regulated by the Interstate Commerce Commission. Such private transportation, however, when provided in commercial motor vehicles designed to seat 15 passengers or more, should be subject to the Federal Motor Carrier Safety Regulations (49 CFR Parts 390-399).

We are deeply concerned about the diversion of bus charter and tour traffic to pseudo-private carriage; that is, to bus and tour operators who are ostensibly engaged in private transportation activities but who are actually engaged in for-hire transportation available to persons and groups having no connection or affinity with a tax-exempt organization. Such charter and tour activity is unlawful and should be curbed by the ICC and the Department of Transportation. The passengers involved in such unlawful transportation may not be protected by the $5 million insurance requirement applicable to interstate, for-hire motor carriers of passengers or by state insurance requirements applicable to for-hire motor carriers of passengers engaged in intrastate commerce.

We believe minimum federal and state safety and financial responsibility requirements should apply to both private and for-hire transporters of passengers in commercial motor vehicles. Subject to that reservation, however, we have no objection to the charter bus and tour service performed by schools, churches, charitable, and other tax-exempt organizations provided that such service is strictly limited to

members of the particular organization and to the purposes for which the organization's tax exemption is granted.

ABA believes that existing law requires that the income derived by tax-exempt organizations from charter and tour service provided to non-members of the organization be taxed as unrelated business income. Under a three-part test established by the Internal Revenue Service in 1950, a tax-exempt organization is taxable if the income-producing activity is: 1) a trade or business; 2) regularly carried on; 3) not substantially related to the organization's performance of its exempt function. The unrelated business income tax was enacted in response to perceived abuses of tax laws by tax-exempt organizations that engaged in profit making activities.

It is clear that the conduct of charter and tour activities by tax-exempt organizations for non-members constitutes a "trade or business" regularly carried on. It cannot be denied that a tax-exempt organization's provision of tour and charter services for non-members constitute a trade or business. U.S. Treasury Department regulations at section 1.513-1(b) define trade or business as "any activity carried on for the production of income from the sale of goods or performance of services." The fact that a tax-exempt school or church provides a similar service in a manner consistent with the organization's tax-exempt purpose does not mean that the service, if provided in a different context, is not a trade or business. We submit that the provision of tour and charter services for the general public is a trade or business.

The charter business, as it is carried on by some schools and churches, is "regularly carried on." In this regard, the IRS looks at the frequency and continuity with which the income-producing activity is conducted; and whether the activity is "pursued in a manner" that is generally similar to comparable commercial activities. Exempt-organization tour and charter service provided on a for-hire basis meets both these criteria. The activity is systematically and continuously carried on and, if the service is available to the general public, the exempt organizations operate in precisely the same way as privately owned, non-exempt charter and tour bus operators.

Under the third prong of the test, the trade or business must have a substantial causal connection to the achievement of the exempt purpose of the organization in order to be tax-exempt. The ABA submits that, while the IRS has determined that a transportation service operated and provided in furtherance of charitable purposes is "substantially related" (see Rev. Rul. 77-246, 1977-2 C.B. 190), the for-hire tour and charter activities of schools and churches is a trade or business that is unrelated to the organizations' charitable purposes. Some schools and churches provide transportation in areas where for-profit bus companies are currently operating or where they are able to provide services. Schools and churches are not granted an exemption to provide transportation services to individuals who have no relationship to the exempt organization.

Therefore, because the for-hire tour and charter activity meets all three criteria of unrelated business activity, all income generated by it must be taxed as unrelated business income. ABA suggests that Internal Revenue Service enforcement be designed to insure that tax-exempt organizations do not report or mischaracterize their unrelated business income.

In conclusion, ABA believes that present law and regulations, as currently interpreted and enforced, do in fact permit unfair competition. To rectify this situation, ABA offers the following suggestions. First, ABA proposes that the Committee provide, through report language or otherwise, that commercial tour and charter activities of tax-exempt organizations not continue to be subsidized by the federal government. Second, ABA submits that federal regulations should not create unfair advantages for non-profit organizations. Third, regulations should be promulgated by the Department of Transportation to require exempt organizations' compliance with federal safety regulations.

On behalf of ABA, I would like to thank the Committee for the opportunity to testify on this important issue.

STATEMENT ON NON-PROFIT ABUSE OF THE UNRELATED BUSINESS INCOME TAX (UBIT)

by

JOHN C. BENNISON
AMERICAN SOCIETY OF TRAVEL AGENTS (ASTA)

before the

U.S. HOUSE OF REPRESENTATIVES SMALL BUSINESS
SUBCOMMITTEE ON PROCUREMENT, TAXATION AND TOURISM

MAY 11, 1993

It is with great pleasure I accept this opportunity to speak before you today and represent the views of the American Society of Travel Agents (ASTA) on the issue of non-profits in travel. My name is John Bennison, Vice President of Government & Corporate Affairs.

First Mr. Chairman, I would like to congratulate you for conducting these timely hearings. As you know, ASTA has been in the forefront in documenting to Congress the unfairness in the market place caused by many non-profit, tax-exempt and federally funded organizations which engage in the sale of travel and travel services and do not pay the unrelated business income tax (UBIT) on their profits. As of now, ASTA's position on the issue of non-profits and unfair competition is straightforward and well-established. In fact, ASTA is a founding member of the Business Coalition for Fair Competition (BCFC), an alliance of trade and professional associations representing thousands of U.S. businesses in all areas of the economy. Its members are dedicated to educating the Congress, the public and others about the nature and scope of the problems caused by nonprofits or publicly-funded organizations engaging in commercial activities in direct competition with existing tax-paying businesses.

ASTA understands the desire of non-profit organizations to raise revenues by engaging in commercial activities that are attractive to their special constituencies or that will appeal to consumers generally because the activities are connected with the name of an organization that the public associates with good works. It is a

sad fact, but true, that voluntary contributions and fund raising within the gambit of tax-exempted activities alone do not yield enough revenue for many non-profit organizations to fulfill their charitable mission.

We would hope, however, that the non-profit sector would recognize that our members, and others who share our view of the issue, are dependent upon their businesses for their livelihood. They must raise and maintain their capital in the open market and pay taxes on their profits.

It is fundamentally unfair, therefore, for the tax-exempt sector to compete directly for business with the tax-paying sector and still receive the obvious economic advantages that tax exemption provides.

The law on this subject under substantially related standards is actually pretty clear... it "imposes a tax on the income from a trade or business, regularly carried on by an exempt organization, if the activity is not substantially related to the organization's exempt purpose.

There may be some travel programs that truly fall within the tax-exempt purposes of a few organizations. For the most part,

however, travel programs are unrelated businesses and the revenue from them should be taxed. The problem, to repeat, is not with the law, but with compliance and enforcement of the law. In these days of unprecedented budget deficits, increased enforcement of the unrelated business income tax laws would be one of the best investments that the government could make.

For well over 25 years, ASTA has been involved with the issue of unfair competition from federally funded and tax-exempt organizations that engage in the commercial sale of travel and travel services and abuse their tax status by not paying the unrelated business tax (UBIT). An example of the abuses that are perpetuated is the one resolved by the Tax Court Docket #8103-83X TC Memo, 1989; filed on January 24, 1989.

In this case, the petitioner, Mr. Helin, signed an application for exempt status under Section 501(c)(3) for his International Postgraduate Medical Foundation. Its stated purpose was to provide continuing medical education to physicians. Mr. Helin was a trustee of the Foundation as well as President of H&C Tours. His agency was used to arrange the tours for the Foundation's seminars.

The tours for the most part were to exotic foreign destinations such as Russia, India, Egypt, Kenya and East Africa, and tours usually lasted for about three weeks. The brochure stated that

medical educational seminars were provided during the tours. However, the Foundation's brochures did not describe the medical curriculum for the seminars and symposia. Reference to medical education in the brochures was limited to a statement that participation qualifies for American Medical Association Category One Credit. Educational activities accounted for less than half of a given tour, and an average of 4 1/2 hours were devoted to educational activities on such days.

The commissioner found that a significant number of the Foundation's operations were used for the purpose of increasing the income of H&C Tours. Approximately 90% of the Foundation's total revenue for 1977, for example, was expended on production and distribution of brochures. The Foundation did not solicit any competitive travel agency bids for its tours. Consequently, in 1977, H&C Tours received $339,667 in gross revenue for air fares and land arrangements as a direct result of the Foundation's tours.

This is an extreme example, but nevertheless it illustrates how easy it is for a non-profit organization to establish an unfair competitive position in the marketplace.

Clearly, Congress must seriously address the UBIT issue and establish better guidelines for controlling the related business activities of non-profit organizations. The House Ways and Means

Oversight Subcommittee held extensive hearings on this issue in 1987 and 1988 in an attempt to find viable solutions. The Subcommittee's draft set of discussion options classified travel and tour services as a tax activity whose nature and scope is considered to be "inherently commercial" rather than charitable, were never adopted. I would encourage this Subcommittee to "dust off" those recommendations as outlined in Chairman Pickle's press release (attached) dated March 31, 1988, for the purpose of reaching urgently needed UBIT reforms. This issue is still clearly one of the major concerns of small businesses across the country.

ASTA feels strongly that it is in the best interest of both the public and private sectors to clarify the role of nonprofits and their place in the private free enterprise system. Thank you for this opportunity to testify today. I will be happy to answer any questions at the appropriate time.

FOR IMMEDIATE RELEASE
THURSDAY, MARCH 31, 1988

PRESS RELEASE #16
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES
ANNOUNCES SUBCOMMITTEE REQUEST FOR PUBLIC COMMENTS
ON DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, today announced the release of the Subcommittee's preliminary discussion options regarding the unrelated business income tax (UBIT). The list of discussion options is a follow-up to the Subcommittee's series of hearings held in June, 1987.

The Subcommittee is interested in receiving comments from the public on the options set forth below. The Subcommittee requests that such comments be provided in writing, no later than April 15, 1988. Written comments received by the Subcommittee will provide a basis for the Subcommittee's development of UBIT recommendations to the full Committee. [Committee rules on page 4 for "Submission of Written Comments" must be followed.] A Subcommittee hearing is expected to be scheduled in late April, following this comment period, to receive testimony from a limited number of invited witnesses. [Details will be provided in a subsequent press release.]

In announcing the Subcommittee's request for public comments, Chairman Pickle stated: "The Subcommittee Members met this week and agreed that public comments should be received on a broad series of options on the unrelated business income tax. This should be done before any Subcommittee decisions are made in the area. The discussion options are not specific recommendations, but serve as the generally agreed to starting point for the Subcommittee's discussion. We recognize the very strong and appropriate concerns both of tax-exempt organizations and the business community in this sensitive area of our tax law. We look forward to constructive and detailed comments by all interested parties."

The Subcommittee's discussion options are the following:

I. "Substantially Related" Test:

Repeal "substantially related" test and replace it with a "directly related" test.

Determine whether each income-producing activity standing alone is tax-exempt.

Retain "substantially related" test; however, impose UBIT on specified activities (as listed in A-L below) whose nature and scope are inherently commercial, rather than charitable.

A. Apply UBIT to gift shop/bookstore income (with exceptions for (1) on-premise sales of low-cost mementos, (2) on-premise sales of an educational nature which relate to the organization visited, (3) in the case of a hospital, articles generally used by or for inpatients, (4) in the case of a university, articles in furtherance of educational programs, or low-cost items (dollar cap), and computer sales not in excess of one sale per

student/faculty per year). In addition, apply UBIT to income from all catalog and mail/phone order or other "off-premise" sales (with exception for de minimis sales, in relation to amount of "on-premise" sales).

B. Apply UBIT to all sales or rental income of medical equipment and devices (including hearing aids, portable x-ray units, oxygen tanks), laboratory testing, and pharmaceutical drugs and goods (with exceptions for (1) inpatients, continuous-care outpatients, or emergency treatment outpatients or (2) items not available in immediate geographic area.)

C. Apply UBIT to income from certain health, fitness, exercise and similar activities unless program is available to a reasonable cross-section of the general public such as by scholarship or fees based on community affordability.

D. Apply UBIT to travel and tour services (with exception for services provided by colleges/universities to students/faculty as part of a degree program curriculum, and de minimis sales to non-students/faculty.)

E. Apply UBIT to adjunct food sales (with exception for on-premise services and/or sales provided primarily for students, faculty, employees, members, or organization visitors).

F. Apply UBIT to income from certain veterinary services such as grooming, boarding, and elective surgery (with exceptions for spaying and neutering, measures to protect the public health, and measures recommended by a veterinarian for the health of the animal).

G. Apply UBIT to hotel facility income which is patronized by the public (with exception for facilities operated, but only to the extent necessary, in furtherance of the organization's exempt purpose). In addition, apply UBIT to certain sales of condominiums and time-sharing units.

H. Apply UBIT to routine testing income (with exceptions for Federal or State mandated activity, pre-surgical medical testing, and laboratory testing which is part of a student educational training program).

I. Apply UBIT to income from affinity credit card/catalog endorsements.

J. Apply UBIT to advertising income and allow deductions from UBIT only for direct advertising costs.

K. Apply UBIT to theme/amusement parks.

L. Apply UBIT to additional specified activities determined to be inherently commercial.

II. **Convenience Exception:**

Repeal "convenience" exception (income from activities carried on primarily for the convenience of a Section 501(c)(3) organization's members, students, patients, officers, or employees). Income from activities that are substantially related to the organization's exempt purpose would remain tax free, subject to the specific rules listed in Section I. above.

III. **"Regularly Carried On" Test:**

Repeal "regularly carried on" test. Income from an activity that is not a trade or business would remain tax-free.

IV. **Tax Treatment of Royalty Income:**

Apply UBIT to royalties measured by net or taxable income derived from the property; or royalties received by an organization for use of property if such organization, or closely related organization, either: (1) created such property, or (2) performed substantial services or incurred substantial costs with respect to the development or marketing of such property. Retain present law for certain non-working property interests, and exception for products that are part of the organization's exempt function.

V. **Deduction from Taxable UBIT:**

Increase $1,000 UBIT deduction for certain Section 501(c) organizations to $5,000 or $10,000, with phase-out beyond $50,000 income level. Limit the increased deduction to activities directly carried on by the exempt organization.

VI. **Unrelated Debt-Financed Income:**

Limit the current law UBIT exception for unrelated debt-financed property to only those pension funds, educational institutions and title holding companies that make at least a 20 percent equity investment of their interest in the property. Retain character of debt-financed income received from all pass-through entities.

VII. **Subsidiaries and Joint Ventures:**

Modify the definition of "control" in the case of exempt organizations having taxable subsidiaries. Define "control" as ownership directly, indirectly, or by attribution of at least 50 percent of stock, by vote or value (rather than 80 percent of combined voting stock, under present law).

Extend "control" rules where exempt organizations in the aggregate own more than 50 percent of the subsidiary's stock.

Provide that a controlled taxable subsidiary's income can be no less than its UBIT would have been if the income-producing activity had been carried on directly by the exempt parent organization.

Aggregate income and activities of controlled subsidiaries for purposes of determining if primary purpose of parent is a tax-exempt purpose.

VIII. **Allocation Rules:**

With respect to facilities used for exempt purposes as well as unrelated business purposes, allow a deduction against UBI for a proportionate share of the direct operating cost of the facility (e.g., maintenance, insurance, and utilities), but not allow a deduction for a share of the general overhead of the organization or for depreciation.

IX. **Tax Information Reporting/Internal Revenue Service (IRS) Administration:**

Expand Form 990-T reporting requirement to include more reporting on: (1) activities and income which the organization claims to be exempt or excluded from UBIT, and (2) revenue sources such as contributions, grants or other funding sources.

Provide more detailed reporting of revenue-producing activities and income on Form 990.

Consider "short form" reporting for small organizations, based on revenues.

Require affiliated group that includes an exempt organization to file a consolidated information return.

Recommend that IRS have an integrated examination program for exempt organizations and subsidiaries (taxable and exempt).

Recommend that IRS conduct the following studies and report on: (1) nonprofit exempt hospital reorganizations (examining the extent, purpose, effect of the use of subsidiaries); (2) exempt organizations that file Form 990s but do not file Form 990-T's (examining activities of a sample group to determine compliance with UBIT); (3) the feasibility of requiring State and Federal land-grant universities to file an information return; (4) the use, purpose and effect of joint ventures; and, (5) study, after five years, on effect of UBIT changes.

X. Miscellaneous:

Codify IRS position (upheld by some courts) that a social club (or other organization whose investment income is subject to UBIT) may not, in determining UBIT, reduce its net investment income by losses on sales to non-members.

Exempt from UBIT an organization's contingent rental income received through a prime tenant, where the prime tenant leases real estate from a tax-exempt organization, the prime tenant's net profits are based on fixed rents derived from subtenants, and the prime tenant does not provide services to subtenants except through an independent contractor.

Exempt from UBIT investment income earned from non-refundable loan commitment fees.

Modify rules applicable to organizations "testing for the public safety."

Consider modification of various piecemeal UBIT exclusions enacted since 1969.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any interested person or organization may submit comments on the discussion options. Persons submitting statements should submit at least six (6) copies by the close of business, Friday, April 15, 1988, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D. C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee

1 All statements and any accompanying exhibits for printing must be typed in single space on legal size paper and may not exceed a total of 10 pages

2 Copies of whole documents submitted as exhibit material will not be accepted for printing Instead exhibit material should be referenced and quoted or paraphrased All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee

3 Statements must contain the name and capacity in which the witness will appear or, for written comments the name and capacity of the person submitting the statement as well as any clients or persons or any organization for whom the witness appears or for whom the statement is submitted

4 A supplemental sheet must accompany each statement listing the name full address a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record

The above restrictions and limitations apply only to material being submitted for printing Statements and exhibits or supplementary material submitted solely for distribution to the Members the press and public during the course of a public hearing may be submitted in other forms

Nonprofit Mail Discounts On Route to Cancellation

By Bill McAllister
Washington Post Staff Writer

To millions, Minnesota Public Radio is synonymous with humorist Garrison Keillor. His weekly tales of life in Lake Wobegon on "A Prairie Home Companion" were noncommercial radio's hit of the 1980s.

But the Minnesota network also has gone commercial, selling merchandise to raise money: $34 Mickey Mouse ties, $22.99 Beatles "Yellow Submarine" boxer shorts, $15 "Northern Exposure" coffee mugs and $49.50 Betty Boop watches.

All those items and more tumble from "Wireless"—a trendy, 42-page mail-order catalogue published in nine editions each year by MPR's burgeoning St. Paul-based for-profit subsidiary. For years, MPR mailed out millions of catalogues at nonprofit rates. Last year the 40 million catalogues it mailed reaped $94.6 million in sales and earned the subsidiary an $8.4 million profit.

MPR's knack for turning a profit has made it a rapidly growing communications conglomerate, the focus of a multimillion-dollar dispute over the cheap postage rates that U.S. taxpayers and postal customers have subsidized for years. The rates are typically 5 to 7 cents a letter below those charged bulk-rate mailers who receive large discounts for presorting and bundling a minimum of 250 letters.

Nonprofit rates—which do not include first-class letters—are supposed to be restricted to charitable or educational mailings by nonprofit organizations, such as church publications or university catalogues.

See MAIL, A10, Col. 1

But so much other nonprofit mail is flooding the Postal Service that agency officials say it has gotten out of hand.

Nowhere is the controversy surrounding nonprofit rates more sharply focused than in a proceeding that postal inspectors have filed against MPR. They have accused the Minnesota network of cheating the Postal Service of $3.1 million by mailing millions of for-profit mail-order catalogues at nonprofit rates. MPR spokeswoman Ginger Sisco said the network had done nothing wrong and that critics are confounded by "the entrepreneurial way we do things."

Even without the fight over its catalogues, MPR's days of cheap mail would be in jeopardy. Because of the federal budget crisis, nearly 400,000 nonprofit organizations—from the Sierra Club to the National Rifle Association—seem certain to face higher postage bills and new restrictions on what they can mail at a discount.

If the National Geographic Society is forced to pay commercial rates for its famous yellow-bordered monthly magazine, its mailing costs would jump from 18 cents a copy to 23 cents, said Robert Sims, a spokesman for the 9 million-member society. That would be enough to force it to boost its $21-a-year membership fee, a step the organization is extremely reluctant to take, Sims said.

The Geographic, the American Association of Retired Persons and the Smithsonian Institution, three of the nation's largest nonprofit mailers, all have built huge national memberships largely through direct mail—sending millions of solicitation letters at prices below commercial rates. The 34 million-member AARP, the nation's largest nonprofit mailer, typically sends 50 million solicitation letters a year.

Officials at the Smithsonian, which like the Geographic also produces a magazine and a mail-order merchandise catalogue, make equally dire predictions. "The only business activities that wouldn't be affected would be our restaurants, because we don't mail them," said spokeswoman Madeleine S. Jacobs.

For budget reasons, the Clinton administration has proposed cutting the taxpayer subsidy for congressionally mandated rates that began in 1951.

Postmaster General Marvin T. Runyon, citing the ballooning of questionable mail, has gone further. He has urged Congress to abolish cheap postage for all but absentee voters overseas and the blind, a fraction of the groups now authorized to use the cheap rates. Many such organizations may be worthy of public support, Runyon said, but "it's really not our position to be the social conscience of the country."

Nonprofit organizations are furious over Runyon's proposal, accusing him of taking "draconian" steps that would ruin their industry and keep the large bulk-rate private mailers—37 percent of the Postal Service's mail volume—happy.

After ignoring repeated warnings of nonprofit abuses, Congress has begun to take the idea seriously.

House and Senate leaders have called Runyon's plan too extreme, but promise to overhaul the current system.

Among changes expected by all sides: higher rates for nonprofit groups, strict limits on what they can mail and "eligibility reform." Rep. William L. Clay (D-Mo.), chairman of the House Post Office and Civil Service Committee, has proposed a phase-in of higher rates over six years and barring nonprofit organizations, like MPR, from using their nonprofit status for commercial purposes. Clay's committee is scheduled to vote on the proposal Wednesday.

R. Neal Denton, executive director of the Alliance of Nonprofit Mailers, said there is no way that Congress will make up the revenue that Runyon says the Postal Service needs to cover nonprofit mail costs: $1 billion. Mailers also agree it is unlikely that Congress will direct the Postal Service to make up the difference by charging other mailers, as it has for the past three years. "For a lot of nonprofits it will represent dramatic changes in their ways of doing business," Denton said.

"They're going to scream," Sen. Ted Stevens (R-Alaska) said of the nonprofit groups. Stevens, ranking Republican on the Governmental Affairs subcommittee overseeing the Postal Service, said he expects groups from Boy Scouts to veterans to rally against his proposal to block the organizations from using cheap mailings for membership drives.

Groups from the American Legion, the nation's largest veterans group, to OMB Watch, a liberal

group that monitors government regulations, have begun to complain. The legion has declared that threatened changes amount to "a death sentence" for nonprofit publications. OMB Watch executive director Gary D. Bass said a Runyon proposal to limit commercial advertising in nonprofit publications would chill free speech rights. "It's very troubling," Bass said.

Runyon, who has built his government career as a hard-liner, sees the issue differently. He argues that too many organizations now use the nonprofit rate and that many have abused it. By refusing to adequately underwrite the costs of nonprofit mail, he said, Congress is effectively imposing a "stamp tax" on other mailers who subsidize the mail of charities and causes they may not support.

College alumni groups that use the cheap rates to mail offerings of travel, credit cards and even grandfather clocks are among the worst offenders, according to Stevens and other members of Congress.

Postal statistics show that not just colleges flood the mails, although 109,875 educational groups have nonprofit mail permits. The most rapid increase in nonprofit mail permits between 1986 and 1991 has been with political advocacy groups. Postal figures show their permits increased 83 percent, rising to 1,206.

Overall, the number of nonprofit mailers has jumped from 12,000 in 1951 to nearly 400,000. Mailers say that the increase masks the fact that many organizations have multiple permits, and that their bulk mailings have leveled off at about 12 billion pieces a year, or about 8 percent of total mail volume.

Still, the 12 billion figure is up sharply from the 819 million pieces in the first year of nonprofit bulk mail, according to Stevens and other critics. "If this trend continues, it's staggering what it'll do to the Postal Service," Stevens said. "We've got to get it restricted." He called the growing use of nonprofit mail by political advocacy groups "improper" and inconsistent with Congress's intent.

In part, the Postal Service caused the problem by liberally granting permits to organizations claiming nonprofit status, members of Congress say. Postal officials concede there is truth to the allegation, but they blame Congress for loosely defining which groups are entitled to the rate.

"As a practical matter the term 'educational' is almost broad enough to defy restrictive definition," the Postal Service has said in a statement, adding, "One person's propaganda is often another's educational or editorial comment."

Currently a wide range of organizations claim nonprofit status. Among them: charitable, religious, educational or scientific organizations; labor, agricultural and horticultural groups; fraternal beneficiary societies; veterans organizations; social welfare organizations; business leagues; social clubs; domestic fraternal groups; and many political parties and political committees.

Minnesota Public Radio's advocates contend that it has been singled out by postal inspectors. Jim Finch, MPR's Washington lawyer, said he had secured more than 200 catalogues mailed by other nonprofit groups since postal inspectors began filing deficiency notices against MPR in December 1990.

Since mid-1991, MPR officials said, they have paid commercial rates "under protest" to get their catalogues out. The catalogues, including one called "Signals" printed for Boston television station WGBH, continue to carry a statement that says they were mailed at nonprofit rates.

It not hard to see why postage is a major issue at MPR. It mails 40 million copies of its catalogues a year, and last year Greenspring Co., its for-profit holding company, said the higher required postage lowered its profits by 27 percent from fiscal 1991 levels.

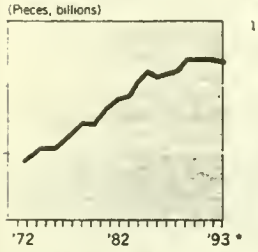
MPR's defenders maintain that every dollar raised through profit-making ventures is one dollar less that MPR will be asking from the public for support of operations.

Still, the extent to which MPR has gone commercial worries some. Richard W. Carlson, president of the Corporation for Public Broadcasting, which gives $3 million a year in taxpayer grants to MPR, said he has asked his inspector general to investigate. "It's damn hard to go up on the Hill and ask for millions of dollars when they're making millions of dollars off Beethoven T-shirts," he said.

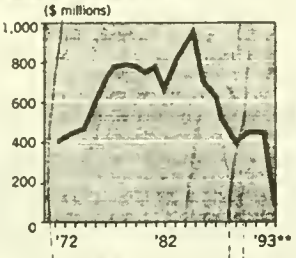
Assuming that Congress forces higher postage permanently on MPR's commercial ventures, the changes are likely to be minor, said an individual familiar with the network: "an increase in 25 cents for the coffee mugs and $1 for the umbrellas."

NONPROFIT MAIL

e volume of nonprofit mail s vastly increased over the st 20 years ...



... but nonprofit organizations face a steep cut in federal subsidies in fiscal 1993.



CES Postal Rate Commission, U.S. Postal Service

* Projected ** Proposed

Delivering Fear to the Elderly on Social Security

By Charles R. Babcock
Washington Post Staff Writer

In 1987, Social Security Commissioner Dorcas R. Hardy went before the House Select Committee on Aging to denounce 13 organizations for mailing "intolerably misleading and deceptive" fund-raising letters pitched at the elderly.

The groups, including one called the National Committee to Preserve Social Security, were playing off fears that Social Security checks were imperiled, she said.

Last month, Sen. Daniel Patrick Moynihan (D-N.Y.), chairman of the Senate Finance Committee, accused Hardy, now director of the McLean-based National Center for Privatization, and Martha McSteen, former acting Social Security commissioner who now heads the National Committee to Preserve Social Security, of having "terrified" senior citizens with separate mailings that said Social Security is running out of money. Secretary of Health and Human Services Donna E. Shalala joined Moynihan, calling the mailings "unethical and outrageous."

A congressional staff report has found a number of direct-mail organizations attempting to raise funds by playing off fears about Social Security. Taxpayers and postal customers help underwrite the costs of such mass mailings, posted at subsidized rates for nonprofit organizations.

Deputy Postmaster General Michael S. Coughlin has described the rapid growth of political advocacy groups claiming nonprofit status: "It's kind of mushroomed." Coughlin has asked Congress to force such mailers to pay higher postage.

Hardy said in an interview, "We're not in the business of scaring seniors." She said she is trying to "tone down the envelope" for her group's mailings. One recent example said: "Inside: Former Social Security Commissioner Reveals the Crisis Facing SOCIAL SECURITY."

The letter inside, Hardy noted, said that Social Security checks for the elderly "are NOT in jeopardy" now, but face problems in coming years.

Direct-mail entrepreneur Richard Viguerie, a leading fund-raiser for conservative causes, is described by Virginia consumer protection officials as having created a network of nonprofit organizations that raise funds and fears among the elderly. His largest organization, United Seniors Association Inc., is based in Chantilly and its mailings seek funds to block a purported White House effort to "raise taxes on seniors and cut Social Security and Medicare."

If Congress heeds the warnings of Sen. Ted Stevens (Alaska), ranking Republican on the Governmental Affairs subcommittee that oversees the Postal Service, these advocacy groups may be unable to mail at nonprofit rates. Stevens said he wants to bar nonprofit groups from conducting membership drives with discounted postage. He also has expressed concern over how many political advocacy groups, such as those on abortion and gun control issues, are using nonprofit status to generate huge volumes of political mail.

Stevens said he wants to restrict nonprofit mail use to what Congress intended when it approved the discount in 1951—allowing groups to communicate with their members.

Staff writer Bill McAllister contributed to this report.

Deep Nonprofit Discounts Mean That Others Pay the Overhead

BY KAVEH SARDARI FOR THE WASHINGTON POST

The Postal Service has encouraged growth of bulk mail by offering mailers deep discounts below the 29-cent price of a first-class letter, if the letters are delivered to a post office presorted and bundled by destination. The result has been a boom in third-class mail, which mailers call "advertising mail" and critics coodemn as "junk mail."

No discounts, however, are deeper than those granted nonprofit organizations. Congress has declared that nonprofit groups have to pay only those costs that can be directly attributed to moving their mail through the Postal Service. That has forced taxpayers or other postal customers to pick up the remaining costs, or overhead, for moving nonprofit mail. Because those costs, which include such factors as heating postal buildings and paying administrative staff, can be considerable, so are the savings to nonprofit organizations.

For example, a nonprofit group is typically charged 12.8 cents to mail a publication that would cost a for-profit publisher 15.9 cents to mail. Even commercial newspapers benefit, getting a price of 7 cents for in-county delivery, compared to a regular commercial rate of 12.6 cents.

The savings mount rapidly as nonprofit groups move into mass mailings and presort letters by Zip codes. Third-class nonprofit mailings presorted by the first three Zip code digits cost 16.4 cents a letter compared to 23.3 cents for commercial firms.

As nonprofit groups increase presorting, the discounts increase. Letters presorted down to the carrier's route can be mailed for 5.2 cents compared to 10.9 cents for a commercial mailer. Letters presorted by the first five Zip code digits can be mailed by nonprofit groups for 8.1 cents compared to the commercial rate of 14.6 cents.

—Bill McAllister

Testimony Regarding Unfair Competition
before the United States House of Representatives
Committee on Small Business
Subcommittee on Procurement, Taxation, and Tourism

by John F. Imler, Director of Government Affairs
California Travel Parks Association

WE DO FACT COMPETITION FROM GOVERNMENT

Most private businesses do not face competition from government agencies. Government operates no chain of shoe stores, no chain of grocery stores, no chain of ice cream stores, no chain of gasoline outlets, however, they operate an extremely large chain of campgrounds and RV parks The RV park and campground industry is perhaps unique when compared with other private businesses in that a government agency is nearly always its largest competitor. We also believe our industry must deal with more competition from more government agencies than any other business enterprise. Our industry faces competition from all levels of government:

-- On the federal level from agencies such as the National Park Service, U.S. Forest Service, Bureau of Land Management, and the Army Corps of Engineers.
-- On the state level primarily from the Department of Parks and Recreation in California.
-- On the local government level from county and city parks departments, fairgrounds, and various water districts.

...NOT ONLY COMPETITION, BUT UNFAIR COMPETITION

From our vantage point, all of these agencies begin unfair competition early on and with numerous frontal attacks on their private sector counterparts.

1. There is the availability of land--often choice land providing unique aesthetics; such as, view sheds or lake and ocean frontage--which would be unavailable to the private businessman. These valuable assets are seldom, if ever, taken into proper consideration when evaluating operational cost or site pricing.

2. Often these various agencies are able to escape many expensive permit processes required of the private sector or are given favored status when permits are required.

3. Many agencies use less than accurate accounting procedures to track the actual cost of development and camping operations. With today's computer capabilities, it is our position that there is no excuse for inaccurate or less than accurate and factual cost analysis of each and

every individual operation. Although the self-insured nature of their operations and their non-tax status give them natural advantages over the private operator, if accurate figures were made available the actual cost of government operated campsites would shocking. We also believe that if those actual cost were made public, higher rates would be easier to obtain from the public users.

4. Many government facilities today avail themselves of the "campground host" program. Here again, government takes unfair advantage of the private operator by being able to employ a "host" or "hosts" in exchange for a summer site and to escape the high cost of workers compensation insurance--all privileges the private operator does not have, since he must pay at least minimum wage for all hours the employee is on duty or on call and for workers compensation insurance.

5. Requirements of health and safety standards is another area of unfair competition. In California, private parks are subject to strict and numerous health and safety regulations from which government parks of all agencies are exempt. We are required to furnish both hot and cold running water, restrooms based on the number of spaces and within 400 feet of spaces without sewer inlets, sanitary dumping facilities for the discharge of sewage holding tanks, and the list goes on and on. Yet, public facilities still operate with chemical toilets, no showers, restrooms far from campsites, and no sanitary dumping facilities. In many cases where private campgrounds are located near public facilities the private operator is presented with the additional problem of the users of those public facilities seeking to use his amenities without payment of any kind. Our question has long been: "If it is necessary for the health and safety of guests in a private campground, why is it not necessary in a public facility." Should not those who make the rules and regulations live by those same rules and regulations? I believe the day for double standards is past.

6. Taxation is another area of unfair competition. In California, private operators are being besieged with numerous new taxes and fees from almost every level of government, while public facilities escape those very same taxes. An example is a state statute adopted in 1993 which allows all local governments to impose a Transient Occupancy Tax (with no ceiling and currently running as high as 12%) "upon the privilege of renting a space in a private campground or RV park," while exempting every government facility from collecting that tax from their customers. Even if government facility site fees were comparable, which they are not, private parks are now 10% or 12% higher. We agree with those who say that "travel, recreation and camping should not be so taxing."

7. All of these factors result in unrealistic site pricing, which often has little or no bearing upon the actual cost of operation. While public parks do have the responsibility of providing pricing within the reach of its citizens, realistically, no matter what price is charged, not all will ever be able to avail themselves of the opportunity to use those facilities. Most users of government facilities are well able to pay whatever an appropriate cost would be.

8. Free camping is yet another area of unfair competition. Private operators cannot comprehend how government facilities can provide free camping. With the current strain on government budgets at every level, the day of providing taxpayer-subsidized free camping is incomprehensible. Below are specific examples of current practices by two federal agencies which are devastating to private campgrounds in two different areas of California.

EXAMPLES OF UNFAIR COMPETITION

1. East of Fresno, California, in the Sierra foothills near the 1000 foot elevation lies Pine Flat Lake. Near Pine Flat Lake and a Corps of Engineers facility are two members of our association: Sunnyslope Campground and Lakeridge Camping and Boating Resort. Mr. Martin Korndobbler of Lakeridge has contacted our office several times relative to the "free camping" that is being provided by the Corps of Engineers. Mr. Korndobbler indicated that, while the Corps' facilities are supposedly closed, at times when his park is void of campers the Corps' campgrounds has up to 14 camping parties.

We have corresponded with the Corps' headquarters and been advised that their policy is not to collect fees in the off-season due to the low occupancy. Mr. Korndobbler indicates that on several occasions visitors have made advance reservations with him for several days but, after arriving and finding out that they can stay free at the Corps' campground, they have checked out and moved to the Corps' campground.

Who of us can resist the "free lunch" when it is made available to us? It is our opinion that this facility should be closed to free camping in the off-season. These campers are using the facilities and water and are leaving behind their trash to be taken care of by the Corps' personnel. While our parks are paying federal, state and local taxes and hoping to eke out a living, the Corps steals their customers, thereby denying them the ability to pay their taxes and overhead.

We can find no justification for this type of business conducted by the Army Corps of Engineers.

2. The Freshwater Lagoon Spit lies along Highway 101 in Northern California, just South of the Town of Orick and the Redwoods National Park Visitors' Center.

This parcel has been owned by California Department of Transportation (CALTRANS) since 1949. It will eventually provide them with a right-of-way for the expansion of Highway 101 to a 4-lane divided highway. The parcel lies next to the Pacific Ocean on the west side of the current roadway and is approximately 100 feet wide and nearly 2 miles long. Due to the failure of CALTRANS to properly post the strip of land with "no parking" signs, over a period of time it became a parking area for individuals wanting a temporary home or a low-priced vacation stop. Estimates of as high as 400 trailers, pick up campers, school buses, and autos per night lined the roadway nightly, creating traffic hazards. Finally--after years of complaints from our association, citizens, and some area businesses--CALTRANS decided to do something to clean up the area.

In 1989 the area was leased to the National Park Service for a 5-year period at the unbelievable price of $1 per year. Now the area has been legitimized and operates as the campground of the National Park Service. It now has fire rings, picnic tables, chemical toilets, trash receptacles, park rangers on horseback, interpretive programs, and a special tenting area. The homeless no longer populate the area. It now appeals to legitimate campers with every type of camping equipment, including motorhomes costing hundreds of thousands of dollars.

Campers traveling Highway 101 in the area of the Freshwater Lagoon are advised on special highway signs to tune their radios to a certain frequency to receive road information. Once tuned to that frequency, they hear the message relative to the "free camping" available to them at Redwoods National Park's Freshwater Lagoon Campground.

Iron Rangers (honor boxes) are used to accept donations for the use of the facilities, and some effort is made to enforce a two-week maximum stay. The Park Service's own reports indicate that they have stolen over 41,000 camper nights from private enterprise in just over 2 1/2 years. That report admits that the toll is probably even higher when it notes: "Many campers were missed because they left early before we completed our census." The reports further indicate that total contributions for the 31.5 month period ending December 31, 1992 have been less than $13,000 while the cost of operation has been nearly $200,000. With severely-restricted Park Service budgets, it does not appear to be good business to operate facilities where income is less than 7% of the cost of operation.

But what effect has this unfair competition had on the private sector? Our parks have been severely affected with many being driven to the very edge of bankruptcy. In the general area, it is reported that five parks will not open for the 1993 season. Other parks in the area--already suffering from the effects of the curtailment of logging and the economic slow down--are laying off employees, delaying maintenance, reducing advertising and making every cut back possible in a last ditch effort to save their businesses, their investments, and their life savings.

There are 2,500 camping spaces operated by private enterprise within 20 miles of the Freshwater Lagoon. No need has ever existed for the National Parks Service to add this money-losing operation to their park or for CALTRANS to allow the continued misuse of its property.

Attached to this report is a letter from Mr. E. L. Wahl, District Director of the California Department of Transportation, dated April 28, 1993. In that letter, Mr. Wahl indicates that his department and the National Parks Service will continue to operate the Freshwater Lagoon Campground as a free campground.

Also attached to this report are copies of appeals from some of our private parks for your assistance in saving their businesses, investments, life savings, and, in some cases, their very lives.

SUGGESTIONS OF WAYS TO ELIMINATE UNFAIR COMPETITION FROM GOVERNMENT AGENCIES

1. Introduce and pass legislation which would mandate that government agencies not develop camping and/or RV spaces in any area until a legitimate demand for such spaces exists which is not being met by private enterprise.

2. Introduce and pass legislation which would require all government agencies to survey all private camping facilities regarding pricing and to establish pricing that directly reflects all costs of operation, value of land and improvements and that is competitive with private enterprise in the area.

3. Introduce and pass legislation which would require that all facilities of government agencies, when closed, be totally closed and posted that any person using such facilities is subject to citation and fine.

4. Require that all currently undeveloped or future acquisitions of any government agency encourage and assist in the development of private camping facilities on the perimeter of such government-owned property, prior to the on-site development of any camping facilities. This step would encourage the preservation of historical and ecologically-sensitive areas from commercial development.

STATE OF CALIFORNIA—BUSINESS, TRANSPORTATION AND HOUSING AGENCY PETE WILSON, Governor

DEPARTMENT OF TRANSPORTATION
DISTRICT 1, P.O. BOX 3700
EUREKA, CA 95502-3700
TDD PHONE 707/445-6463

(707) 445-6445

April 28, 1993

Freshwater Lagoon

Don McKay, President
Klamath Chamber of Commerce
P. O. Box 476
Klamath, CA 95548

Dear Mr. McKay:

Bill Ehorn, Redwood National Park Superintendent, and I recently met to discuss the results of the Orick Chamber of Commerce meeting held on April 5, 1993, that included an open discussion on the present and future management of Freshwater Spit. I understand that in addition to the Orick Chamber members, Anna Sparks, Humboldt County 5th District Supervisor, Bill Ehorn, Clay Nystrom, Deputy District Director for Caltrans District 1, and you were present and answered questions and expressed concerns over management of the Spit.

As a follow-up to the chamber meeting, Mary Lou Shipton wrote to you suggesting that studies be conducted, presumably by Caltrans or the Park Service, to determine potential economic impacts of any change to the current management of the Spit. While a study would be of great interest to us all, Bill Ehorn and I agree that the proposed study is unlikely to alter the positions of either Orick or Klamath. As Supervisor Sparks suggested at the meeting, Caltrans does have the expertise to conduct the study; however, in order to do so we would have to delay studies that are currently under way for major highway improvements such as the ones at Wilson Creek and Cushing Creek on Route 101 in Del Norte County. Faced with the almost impossible task of satisfying the diverse interests that are involved in the Freshwater Spit issue, I do not think delaying vital highway studies is an acceptable trade.

Another interested player in all of this is the California Travel Parks Association. They have made it clear that anything short of closing the Spit to overnight camping will be unacceptable to their organization.

Caltrans and the National Park Service have stated publicly and in writing that we will work together towards changes in the management of the Freshwater Spit providing that there is support

from the Orick and Klamath Chambers of Commerce in the form of a joint resolution. This support has not materialized.

The only item that all interested parties agree to is that the appearance, preservation, and operation of the Spit has been greatly improved under the management of Redwood National Park. In the absence of unified support for changes in the management of the Spit, Bill Ehorn and I have agreed to continue with the current arrangement. Future examination of the use of Freshwater Spit will be undertaken when conditions dictate.

Very truly yours,

E. L. WAHL
District Director

cc: Mary Lou Shipton, President
Orick Chamber of Commerce
Orick, CA 95555

William H. Ehorn, Superintendent
U. S. Department of the Interior
National Park Service
1111 Second Street
Crescent City, CA 95531

Anna Sparks, Supervisor - District 5
Humboldt County Board of Supervisors
Courthouse, 825 Fifth Street
Eureka, CA 95501-1172

California Travel Parks Association, Unit 12
% Mad River Rapids RV Park
3501 Janes Road
McKinleyville, CA 95521

California Travel Parks Association
Attention John Imler
P. O. Box 5578
Auburn, CA 95604

Klamath Camper Corral

NORTH END 101 BRIDGE, ON THE RIVER

707--482-5741
P. O. Box 729
Klamath, Calif. 95548

October 13, 1992

John Baird
2700 Poppy Drive
Brooktrails, Ca. 95490

Dear John,

Here's the information on the decline in occupancy of my R.V. Park resulting from the 1990 take over of the Fresh Water Lagoon Area by the Redwood National Park.

We believe it is unfair competition to have the National Park Service supplying free camping and targeting the overnight R.V. tourist which has been the mainstay of our business.

These figures from our records are open for inspection. July, August and September overnight camping totals:

1989	4882
1990	4152
1991	3651
1992	2897

We have not been able to raise our rates since 1989 even though almost all camps in the North State have much higher prices. We are not able to compete with a free camp in our area. The loss of 2,000 campers since 1989 has cost us approximately $30,000 in 1992 alone. We cannot afford to see what 1993 season will be if this unfair competion is allowed to continue.

Thank you again for your concern.

Sincerely,

Marv Cooper

Drive Through Spaces — Recreation Room — Coin Operated Laundry — Showers — Picnic Tables — Barbecue
Central Sanitation Station — Individual Connections

Klamath Camper Corral

NORTH END 101 BRIDGE, ON THE RIVER

707-482-5741
P. O. Box 729
Klamath, Calif. 95548

October 13, 1992

To Whom It May Concern;

We the undersigned RV Park owners and related businesses have suffered dramatic loss of income as a result of the illegal RV Park operated by the National Park Service at Freshwater Lagoon, Orick, California.

Our businesses have suffered to a degree of in an excess of 100 camper nights daily. This computes into thousands of dollars to related businesses in the community. Instead of a decline in camper nights as promised by Wm. Ehorn, Director of Redwood National Park Service, there has been an increase. This is an increase in overnighters who would have spent money in our community. These are not "homeless" people, judging by the value of their RV's, these people who can/would spend money in private campgrounds.

We need your help to put a stop to our tax dollars being spent in direct competition to small businesses in Del Norte and Humbolt Counties.

Sincerely,

Marv Cooper, Camper Corral

Chub Morris — Riverwoods Campground

Strawns RV Park

Robert L Harp — Blackberry Patch R.V. Park

Riffles Trailer Park

Redwood Rest Resort

Drive Through Spaces — Recreation Room — Coin Operated Laundry — Showers — Picnic Tables — Barbecue Central Sanitation Station — Individual Connections

Bob Bostwick

Jenny Bostwick

P. O. Box 128 Klamath, California 95548 Phone (707) 482-3405

TRAILER PARK ★ BOAT DOCK ★ TACKLE

To Whom It May Concern, 10-13-92

We the undersigned R-V Park owners and related businesses have suffered dramatic loss of income as a result of the illegal R-V Park operated by National Park Service , Freshwater Lagoon, Orick, California. Our businesses have suffered to a degree of in an excess of 100 camper nites daily. This computes into thousands of dollars to related businesses in the community. Instead of a decline in camper nights as promis ed by Wm. Ehorn, Director of Redwood National Park Service, there has been an increase This is an increase in overnighters who would have spent money in our community. These are not "homeless" people, judging by the value of their R-V'S, these are people who can/would spend money in private campgrounds..

We need your help to put a stop to our tax dollars being spent in direct competition to small businesses in Del Norte County.

Sincerely,

Bob/Jenny Bostwick, Owner/Managers Kamp Klamath R-V Park

Chinook R.V. Resort

Camper Corral R.V. Park

Riverside R.V. Park

Golden Bear R.V. Park

Rivers West Outfitters

Terwer Park Resort

Mystic Forest R.V. Park

GOLDEN BEAR R V PARK
PO BOX 388
KLAMATH, CA. 95548

APRIL 26, 1993

CALIFORNIA TRAVEL PARKS ASSOCIATION
P O. BOX 5648
AUBURN, CA. 95604

I AM WRITING REGARDING THE FREE CAMPGROUND BEING OPERATED BY THE REDWOOD NATIONAL PARKS ON THE BEACH SOUTH OF ORICK, CALIF.

WE ARE THE OWNERS OF THE GOLDEN BEAR RV PARK HERE IN KLAMATH CALIF. OUR PARK IS DESIRABLY LOCATED ON THE BANK OF THE KLAMATH RIVER BETWEEN HIGHWAY 101 AND THE RIVER. WE PURCHASED THE PARK IN 1988. THE FIRST THREE YEARS WE COULD COUNT ON TEN TO FIFTEEN OVERNIGHTERS. NOW THAT ORICK BEACH HAS BEEN UPGRADED OUR OVERNIGHT TRAFFIC HAS BEEN SEVERELY CURTAILED.

WE DON'T BELIEVE IT IS FAIR FOR US TO HAVE TO PAY TAXES TO SUPPORT GOVERNMENT COMPETITION.

WE FUTHER UNDERSTAND IT IS NOT LEGAL FOR RV'S OR TRAILERS TO PARK OVERNIGHT ALONG THE HIGHWAY.

WE THANK YOU FOR KIND ATTENTION TO THIS MATTER.

GOLDEN BEAR PARK
DONNA IRWIN

Riverwoods Campground
Box 589
Klamath, Ca. 95548

April 30, 1993

John Imler
C.T.P.A.

Sir:

This letter is in regard to the takeover of the spit at Freshwater Lagoon by the Redwood National Park in 1990. First let me state that my campground is not a "fishing camp" but caters to and relies on the people who are traveling through the area and who are here to enjoy the scenery and natural attractions.

Since the illegal takeover of the spit by R.N.P in 1990 my business has seen a steady decline as the word of this free campground has spread. One of the most common questions asked by our customers is where is this free camping area and how do we get to it. I keep a yearly record of my business and since the takeover in 1990 my business has declined as follows: 1990- 8%, 1991 - 25%, 1992 - 36%.

There is an abundance of private campgrounds and R.V. parks in this area that are able to more than adequately meet the needs of the visitors to this area. There are also four State Park Campgrounds in this area who are here to meet the needs of our visitors. In conclusion, let me put it mildly that I am against the R.N.P. campground at Freshwater Lagoon as it is now or if they provide water and charge $10.00 per night as predicted.

I would support Your and C.P.T.A.s efforts efforts to halt this illegal camping area in whatever way possible.

Thank you in advance,
Chub Morris
Chub Morris

CHINOOK R.V. RESORT

P.O. Box 7 • Klamath, California 95548 • (707) 482-3511

Camping & Fishing On The Klamath River

April 30, 1993

A REVIEW OF RV OCCUPANCY OVER THE PAST FIVE YEARS:

During 1992, our RV occupancy has decreased 35% from 1988. We had 25,550 nightly sites available in 1992, whereas we only rented 3,092 of them as camper nights. That means for 1992, our occupancy percent was 12%.

On the other hand, we also have a small convenience and off-sale liquor store. During the same period, from 1988 to 1992, business increased 21%. Had our RV occupancy been up to where it was expected, the store business increase would be even greater.

There may be several factors causing the occupancy decrease, but one stands out because we feel it is unfair competition from the federal goverment - when the National Redwood Park offers "free overnight RV parking" at the Freshwater Lagoon - less than 20 miles south of us. One cannot blame the RVer - its hard to pass up a "Free Night." The NRP RV facility does not even meet the minimum code standards that we private parks must adhear too. Before the NRP offered their "free camping", there were three state campgrounds with the Redwood Parks and plenty of private rv/campgrounds to the south, in the middle and to the north. When the NRP offered "free overnight parking," they added unfair competition. Yes, the Freshwater Lagoon beach is very nice, but it should be used for "Day Use" only!

Sincerely,

J. Gus Isenburg

KLAMATH CHAMBER OF COMMERCE
PO. BOX 476 KLAMATH CA. 95548
PHONE (707) 482 - 7165

9 MARCH 1993
TUG & JUDY MILLER
CTPA CENTRAL OFFICE
P.O. BOX 5648
AUBURN, CA. 95604

DEAR TUG & JUDY

It has been brought to the attention of the Klamath Chamber of Commerce that you are working to change the status of the Fresh Water Lagoon FREE camping. This is also a concern of this Organization that this FREE camping be curtailed.

There are several ways to accomplish this task as you well know. One way would be to close the whole operation down thus creating the eye sore that existed prior to the Redwood National Park assuming the control of this area. Another way to change the situation is to make this area a day use only beach. This can be accomplished by placing no overnight parking / camping signs along the strip. This was done along the beach front in Crescent City and now we have a beautiful beach to use and view.

This would allow Cal Trans to maintain the area as well as shut down the FREE camping on the North Coast that now affects all of the campgrounds in this area.

Thank you for your support in this urgent matter.

Don MacKay President
Klamath Chamber of Commerce
P.O. Box 476
Klamath Ca. 95548

TESTIMONY ON UNFAIR COMPETITION FROM THE PUBLIC SECTOR

AFFECTING PRIVATE SECTOR CAMPGROUNDS

BY
S. EVERETT LOVELL, JR.
OWNER, AQUIA PINES CAMPGROUND, STAFFORD, VIRGINIA
CHAIRMAN OF THE BOARD, VIRGINIA CAMPGROUND ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON PROCUREMENT, TAXATION, AND TOURISM
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES
MAY 11, 1993

I am Everett Lovell, owner of Aquia Pines Campground, which is located south of Washington, D. C., in Stafford, Virginia. Thank you Chairman Bilbray and Ranking Republican Member Mr. Baker for this opportunity to express my views as a small business owner concerning unfair competition from the public sector. I am representative of the many two hundred plus private rural campgrounds in Virginia, and the thousands of rural campgrounds nationwide. My testimony will identify public agencies that affect my campground, offer data relating to the unfair competition, and offer solutions that could avoid the unfairly competitive situation.

There are two specific issues I will address:

1) Proposed construction of camping facilities at Fort Belvoir, Virginia, and
2) Overnight parking in the interstate highway rest areas.

As a small businessman, I do not mind fair competition. My competitors will incure similar costs, and struggle with the same limited resources as I do. Unfair competition occurs when the government, either local, regional, state, or federal, becomes a provider of services which directly compete with the private sector for the limited market. The government does so with no regard for return on investment, nor cost of operations.

Proposed Construction of Unneeded Camping Facilities
Outdoor Recreation Department, U.S. Army, Fort Belvoir, Virginia

Introduction

My business, Aquia Pines Campground, faces unfair competition that will exist if a proposed campground/marina/restaurant club complex is built at Fort Belvoir.

No one disputes a secondary mission of a military facility is to provide recreation for both active duty and retired military personnel. To accomplish this mission, clearly the Army does not need to construct, own and operate facilities which duplicate services offered by the private sector. Many campgrounds in both Maryland and Virginia serve local residents, retirees, and travelers visiting the metropolitan Washington, D.C., area.

The most cost efficient method to provide camping to military personnel either in or visiting the metro area would be for the Department of the Army to issue vouchers for use in existing local public and private campgrounds. U.S. Army officials should strive to bring the lowest cost camping possible to military personnel concomitant with no job or tax revenue loss to the local economy. The Army should not seek to remove low cost private sector jobs and replace them with high cost federal jobs given the limited demand for services.

It is wrong for the federal government to continue planning these facilities while ignoring the fact that these facilities are not currently needed, and that the construction will negatively impact existing small businesses. With the continual downsizing of the U.S. military, there will be even less need for non-essential facilities, such as outdoor recreation, in the future.

Sufficient Campsites Exist to Meet the Demand

Private campgrounds oppose the construction as surveys have shown sufficient campsites exist to meet the needs of the public. The Virginia Campground Association surveyed campgrounds this past summer concerning occupancy levels. They found that in July, the peak season, forty-six percent of the campsites were occupied: that means over half the campsites were empty. Mr. William Semans of the Outdoor Recreation Department at Fort Belvoir told me on August 14, 1992, that while visiting campgrounds this summer, he was surprised to learn of high vacancy levels.

Mr. Semans' justification for construction was a projection done by the Virginia Department of Conservation and Recreation: The 1989 Virginia Outdoors Plan. The Plan estimates that in 1990, the Northern Virginia Region will need 62% more campsites than it has in inventory. Mr. Semans observations of the high vacancy rates do not coinside with the Plan's projections. (I consider the Plan to be inaccurate, as it estimates one in five Virginians camp.)

Furthermore, the Virginia Department of Conservation and Recreation (VDCR), which wrote the Plan, has no plans to build camping nor cabin facilities in either of the two parks being constructed in the Northern Virginia Region and the Fort Belvoir area; Leesylvania and Mason Neck State Parks. If the VDCR considers the lack of camping facilities so important, why not add sites to these two parks?

Clearly there is an adequate supply of campsites in the Fort Belvoir and Washington area.

History

In August 1992, a campground manager telephoned me to express alarm that the U.S. Army proposed to build a campground marina restaurant country club complex at Fort Belvoir, Virginia. Upon learning of these proposed plans to build overnight accommodations at Fort Belvoir, specifically, a camping facility, I placed many calls in an effort to learn details of the project. After locating the correct office, I called several times over several days, identifying myself and my concerns. I repeatedly requested a meeting. I was told repeatedly that someone would return my calls. No one ever did.

On August 14, 1992, I spoke with an angry Mr. William (Bill) Semans (703-805-3781) of the Outdoor Recreation Department at Fort Belvoir. I expressed the concerns shared by campground owners and their associations about the proposed project and the impact on local businesses. He initially agreed to meet with us to explain the project upon his return from vacation in September. He also agreed to call me to schedule a meeting. He never did.

In early October, I telephoned Mr. Semans again. He was very upset, and refused to meet with representatives of the private sector campgrounds. He claimed someone wrote a letter to a Senator questioning the project. While assuring him that I had not written any letters, I wondered what he was trying to hide.

After Fort Belvoir Outdoor Recreation personnel refused to meet, campground owners wrote letters to congressmen and state representatives. I wrote a letter to Senator Robb on October 21, 1992, that represented concerns of seven private campground owners around the Washington, D.C., area, who opposed the construction of the campground. Mr. David Gorin, Executive Vice President, National Association of R/V Parks and Campgrounds, stated strongly in a letter to Senator Warner that "Our opposition is based on the knowledge that there are sufficient camping facilities with ample space to accommodate all campers in the immediate area. Construction of the proposed facility by the U.S. Army will contribute to the loss of jobs, taxes, and other economic considerations in the private sector."

In response, the Department of the Army has made several

statements to try to justify the proposed construction of camping facilities at Fort Belvoir. These statements lack credibility once the facts are considered.

1) Colonel John P. McLaurin, III states in his letter to Congressman Herbert H. Bateman "There are no private campground owners within a twenty mile radius of Fort Belvoir who would be adversely affected by this project." This is true only because there are no private campgrounds within twenty miles of Fort Belvoir. The project will negatively impact private campgrounds within several hours drive of Fort Belvoir. He also failed to note that private campgrounds as far away as Front Royal operate shuttle service to the Washington Metro, as they rely on tourists to remain in business.

Also lacking is any note of the county, regional, and federal camping facilities in the Fort Belvoir area.

2) Col. McLaurin states that the campground "initiative was strongly supported by the 1989 Virginia Outdoor Recreation Plan, which highlighted the lack of camping facilities in the area." This is false. The Plan fails to even mention the Army's proposed marina campground restaurant club complex. The Plan calls on the military to open its land and facilities for public use (page 108).

3) Col. McLaurin states "The campground initiative was developed in 1987, in response to requests from military visitors to the National Capitol Region..." In assessing the need for campsites, he fails to mention that a new 400 campsite campground has been built next to the Washington Beltway, I-95/495, since 1987.

Mr. Semans stated in phone conversation on August 14, 1992:

1) The facilities would be for active or retired Army. He has already hosted a 156 unit SMART club, a retired Army camping club.

2) The proposed camping facility will be a destination for Army visitors to Washington.

3) After visiting many of the campgrounds in the area, he admitted that the campgrounds were surprisingly empty, yet the study published by Virginia says more campsites are needed.

4) He does not have to consider the impact on businesses outside of a 20-mile radius of Fort Belvoir. While the 20-mile rule may be appropriate for gas stations, campers frequently travel in excess of 20 miles to enjoy a weekend outing.

5) The Outdoor Recreation Dept. will pay rent to the Army for the federally owned water front property on the Potomac. He did not state who would pay to relocate the displaced military boat units which recently vacated the proposed recreation and marina club area.

6) He stated the projects do not have to be economically feasible, and he is only required to charge 70 % of what local private businesses would charge, although he does not have to factor into the calculation the prime waterfront location.

Ms. Cathleen A. Magennis, Secretary of Economic Development for the Commonwealth of Virginia, shares my concern "about the competitive situation that their installation poses."

Possible Solutions

The Army could provide very low cost, or even free, camping to its personnel by issuing vouchers, which could be redeemed for camping at any campground. Personnel in the area could then choose which type of campground they wished to visit: seashore, bayside, mountain, primitive, or well developed. Personnel visiting the area also have many campsites from which to choose; private campgrounds as far away as Front Royal, Virginia, operate shuttles to help their campers visit Washington, D. C. The campgrounds would then bill the Army, probably at the end of the season, for reimbursement.

In conclusion, I oppose the planned construction of camping facilities at Fort Belvoir because there is currently an oversupply of campsites and cabins in the Washington, D. C. area. Furthermore, this ill-conceived construction project will directly and unfairly compete with many small, taxpaying businesses which serve residents and tourists in the Washington, D. C. area.

I will appreciate any help you, your staff, or The President may offer to stop the proposed construction of an unnecessary campground facility at Fort Belvoir.

Overnight Parking in the Interstate Highway Rest Areas

Introduction

Thank you for your attention to the problem of overnight sleepers in the interstate rest areas. The overnight use of the rest areas is often greatest during our slow seasons when the campgrounds are empty: late fall, winter, and early spring. This problem is a major issue for Aquia Pines Campground, and other campgrounds located next to interstate highways. I conservatively estimate that Aquia Pines loses $ 80,000.00 in revenue each year. This equals $ 3600. in sales taxes, and $ 1600. in rooms taxes. If I had this revenue, I would hire at least one extra adult and two part time high school students.

The Virginia Campground Association supports the use of the rest areas as resting areas. We are opposed to their use as overnight sleeping areas. During surveys, which we have conducted over the past six years, we have noticed some vehicles returning to the same rest area night after night. Clearly they are being used for purposes other than which they were constructed.

Allowing campers free use of the state's facilities constitutes unfair competition.

The Problem

Rest areas in Virginia are often used as campgrounds by travelers as Virginia is a good one day stopping point for the drive to New England or New York. Enclosed are surveys conducted by members of the Virginia Campground Association. You will note that the Dale City I-95 rest area is not the area with the most violations. Also note that surveys were conducted during slow periods of interstate camper traffic.

For example, on Saturday December 21, 1991, at 4:50 a.m. in the Dale City I-95 Southbound Rest Area, I counted 21 or 22 camping vehicles. I telephoned the State Police dispatcher. I returned at 5:45 a.m. to find nothing had been done. I again telephoned the dispatcher, and spoke with Mrs. Rupert. A trooper sat in front of the rest area on I-95 South with radar. I had two campers register that night.

Illegal overnight parking is obviously costing private campgrounds thousands of dollars in lost profits and reducing federal, state, and local tax revenues each year. It is not so obvious that motels and hotels are also loosing money as people sleep in their cars. (Not included in the 1987 survey of Dale City was one person who slept in a station wagon approximately eight of the eleven nights.)

The Virginia Division of Tourism has been extremely successful at promoting the historic and scenic aura of Virginia. (My campground had campers from 47 states and 17 countries in 1991-a

slow year.) It does not make sense to encourage tourists to pass through the state without leaving the interstate! Not only are they using state facilities and services for free when they camp overnight in the rest areas, they are also costing taxpayers money. They offer no revenue to the state-just a burden on the Commonwealth. The state is maintaining facilities that were initially federally funded, while allowing illegal use of the rest areas.

History

Virginia Campground Association (VCA) representatives have been working with various Virginia officials since 1985 to reduce illegal overnight sleeping in the interstate rest areas.

Memos between the Virginia Department of Transportation, the Virginia State Police, and the VCA document the long standing problem.

After a request from VCA, the Virginia Dept. of Transportation in 1985 changed rest area signs to read "2 Hour Parking Limit." This was because the "No Overnight Parking" signs were not deterring overnight parking. VDOT's A. L. Thomas stated in a February 13, 1985 memo "We realize that enforcement will be the key to the effectiveness of this parking restriction and are asking the State Police to support us in this matter to the extent possible."

Possible Solutions

To reduce overnight sleeping in the rest areas, I recommend three low cost action items.

1) Advertise. Press release. These are much less expensive than additional manpower for enforcement of regulations. Inform the public that the rest areas were constructed to promote highway safety. They are not intended as havens for illegal activity, including overnight lodging. These messages are very well received by the traveling public when compared to a citation and fine. A simple letter to several travel organizations could ask that they inform their membership. These letters would be a "We request your assistance" type.

2) Increase deterrents. The Virginia Department of Transportation should increase the fine to a flat $100.00 for exceeding the parking limit. This fine should be posted in highly visable places, such as a sign "WARNING: $100.00 FINE" posted over the current 2 hour parking limit sign. I would also suggest some signs be posted in or near the bathrooms stating:

> "Welcome to Virginia. In an effort to keep traffic flowing in the rest areas, we kindly request limiting your stay in the rest area to TWO HOURS. Violators will be towed and/or fined. WARNING: $ 100.00 FINE. If you need assistance, telephone ...."

3) Enforcement. Unfortunately, tickets will have to be written before people will pay any attention to the signs. The current $ 20.00 fine for disobeying a highway sign is a poor deterrent.

We realize the Virginia State police are facing a resource shortage as are all state agencies. Increasing manpower is not an option.

Unfortunately, this problem has not been a high priority for the State Police. Delegate William (Bill) Howell, representing Stafford County and thus Aquia Pines Campground, has noted campers in the rest areas on his trips to Richmond in the wee hours of the morning. During one night when he patrolled with a State Patrolman, he asked the officer about the campers. The patrolman told him that campers were not a priority. Despite repeated letters requesting action, the state has continued to condone this illegal activity while focusing their resources elsewhere.

Closing

The Commonwealth, cities, and counties continue to demand increasing revenue from businesses via skyrocketing electric utility taxes, highway logo fees, lodging and meal taxes, beer and wine taxes, etc. If the current trend continues unchecked with more people sleeping in rest areas than in campgrounds, some of the very businesses which are expected to pay taxes will cease to exist. The federal, state, and local tax base will continue to erode. Voters will demand state and federal parks, that will demand new government financing. It will be much less expensive to support private businesses now than to build and maintain state and federal parks in the future.

8

DEPARTMENT OF THE ARMY
OFFICE OF THE SECRETARY OF THE ARMY
WASHINGTON, DC 20310-1600

OFFICE, CHIEF OF
LEGISLATIVE LIAISON

3 DEC 1992

Honorable Herbert H. Bateman
House of Representatives
Washington, D. C. 20515

Dear Congressman Bateman:

Thank you for your letter dated November 12, 1992, on behalf of Mr. S. Everett Lovell, concerning the proposed construction of an outdoor recreation campground at Fort Belvoir.

An environmental assessment study for this project will be completed in the February/March timeframe. There are no private campground owners within a twenty-mile radius of Fort Belvoir who would be adversely affected by the project. The campground initiative was developed in 1987, in response to requests from military visitors to the National Capitol Region who cited the need for a military camping facility in this area. The initiative was strongly supported by the 1989 Virginia Outdoor Recreation Plan, which highlighted the lack of camping facilities in the area. Additionally, a recent survey of local active duty Army personnel and their family members rated this project as their first recreational construction priority.

Upon request, we will also provide an indepth briefing and tour of the proposed construction site for you and/or any of your staff who would be interested.

Your interest in the Army recreation program is appreciated and I hope the above information is helpful.

Sincerely,

JOHN P. McLAURIN, III
Colonel, General Staff
Chief, Investigations and
Legislative Division

COMMONWEALTH of VIRGINIA

Cathleen A. Magennis
Secretary of Economic Development

Office of the Governor
Richmond 23219

(804) 786-7831
TDD (804) 786-7765

December 30, 1992

Mr. S. Everett Lovell
President, Aquia Pines Campground
3071 Jefferson Davis Highway
Stafford, Virginia 22554

Dear Mr. Lovell:

Senator Robb has shared with me your letter to his office about the proposed construction of campground facilities at Fort Belvoir, Virginia.

In reviewing current Army regulations, it is part of the mission of a military facility, where possible, to provide recreation areas, including campsites, for the use of active duty and retired military personnel. Requirements for these areas are developed on the number of military personnel that they are required to serve without consideration to public or private sector facilities surrounding the military post. They are developed to provide the active-duty and retired military personnel and their dependents with a program at the lowest cost possible and, therefore, do not take into consideration a profit motive as does a private sector campground.

However, we share your concern about the competitive situation that their installation poses, especially in light of the high number of retirees and active duty travelers to the metro Washington, D.C. area and the impact they have on our tourism economy.

I have asked Patrick A. McMahon, Virginia's Director of Tourism, who also has an extensive military career background, to assess the situation. I'm sure he will be contacting you in the near future after he talks to representatives at Fort Belvoir and the Pentagon.

Thank you for alerting us to your concerns about the economic vitality of the Commonwealth.

Sincerely,

Cathleen A. Magennis

CAM/ssh

cc: The Honorable Charles S. Robb
The Honorable John W. Warner

COMMONWEALTH of VIRGINIA

Cathleen A. Magennis
Secretary of Economic Development

Office of the Governor
Richmond 23219

(804) 786-7831
TDD (804) 786-7765

March 4, 1993

Mr. S. Everett Lovell
President
Aquia Pines Campground
3071 Jefferson Davis Highway
Stafford, Virginia 22554

Dear Mr. Lovell:

Thank you for your letter of February 15 about your continued concern over the development of campground facilities at Fort Belvoir, Virginia.

Pat McMahon has been in contact with officials at Ft. Belvoir and has discussed your concerns with them. He will continue to work with officials at Ft. Belvoir regarding alternatives to their campground plans, along with several alternatives you had mentioned in your letter.

One point Mr. McMahon derived from recent discussions is that the U. S. Army feels a duty to provide recreational support to the military personnel within the confines of their military facilities. They have a number of reasons for this based on their mission and regulations in providing recreational support to the military and their dependents. As you may be aware, on the whole, military personnel look to military facilities to provide recreational support on a military base.

Also noted in Colonel McLaurin's letter to Congressman Bateman, there is an environmental assessment study being done at this time. This assessment will look at the impact on the local area along with the needs of the service. When the environmental assessment has been completed, Mr. McMahon will meet with officials at Ft. Belvoir to review the assessment and continue discussions as to possible alternatives. I am sure that he will be contacting you as soon as he has met with these officials to advise you on the matter. As I think you are aware, the Commonwealth of Virginia cannot halt the construction of a campground on a federal military compound. However, we can continue to support the need for the military to look for alternatives.

V·C·A
VIRGINIA
CAMPGROUND
ASSOCIATION

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October 23, 1992

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Executive Vice President
Robert M. Ramsey, CAE

The Honorable John W. Warner
c/o Susan Schroeder
United States Senate
Washington, DC 20510

Dear Senator Warner:

In July, the busiest camping month in Virginia, one half of all private campground sites sat empty! In spite of this 50 percent occupancy in Virginia's private campgrounds, Fort Belvoir is planning to build new camping facilities.

I am writing to urge your assistance in opposing the construction of R.V. sites at Fort Belvoir. The existing private campgrounds and R.V. Parks along I-95 have more than sufficient space to handle any R.V. needs for the area served by Fort Belvoir and the surrounding Washington D.C. area.

I believe the government should not compete with private enterprise and am asking for your support in stopping this planned facility on federal property.

It will not bring increased revenue to the government. It will increase costs to the government; and it will definitely reduce the private sectors customer base, thereby decreasing our tax and employment contributions toward a sounder economy.

Sincerely,

John T. Rust
President

JTR/agw

bcc Everett Lovell

October 23, 1992

Ms. Susan Schroeder
Office of Sen. John Warner
U.S. Senate
Washington, D.C. 20510

Dear Ms. Schroeder:

I am writing to you today to voice my opposition to the proposed construction of camping facilities at Fort Belvoir.

My wife and I manage a resort campground with complete facilities of 700 sites and 22 cabins. We attract campers from all the Eastern states. The campers use us as a base and visit Williamsburg, Yorktown,Wallops Island, Annapolis and the Washington D.C. area.

We are open all year and employ a base staff of 15 people. We swell to a staff of 100 for five months (peak season).

Our current occupancy rate for the year is 25% of all sites. Our peak season May-September we only have an occupancy rate of 52%. In other words during our five month season we are only half full. In our two busiest months, July and August we average 156 empty sites per night. Our peak two months occupancy was 78% or about three quarters full.

We spend $100,000. yearly on advertising to attract campers to our resort and the state of Virginia. Every dollar of revenue we lose to a state or federally funded facility (Fort Belvoir)is effectively a dollar of lost profit. If we lose 20% or our business to a federally funded campground we will go from a profitable business to an unprofitable one. If we become unprofitable and are forced to close, our 100 tax paying consumer spending employees will no longer have jobs and in effect will become wards of the state and federal unemployment program. Needless to say our advertising, merchandising, equipment, etc, etc spending will cease and affect many businesses around the state of Virginia.

With the amount of sites we still have to offer it is unconscionable to me to have a federally subsidised facility build a campground.

I request that the Senator examine his position on this matter and side with the private campground industry in Virginia and not in favor of using tax payer money to subsidise a campground at Fort Belvoir. Allow us to continue to provide to the Virginia tourist the type of facility they have come to expect and to which they are entitled from the private campgrounds of Virginia.

Yours truly,

Ed Davidson

Ed Davidson,
General Manager

c.c. Everett Lovell
Aquia Pines Campground

4100 GUINEA STATION ROAD
TELEPHONE (703) 898-7252

Fredericksburg KOA
Franchise of Kampgrounds of America, Inc.
FREDERICKSBURG, VIRGINIA 22401

October 22, 1992

Ms. Susan Schroeder
Office of the Sen. John Warner
U.S. Senate
Washington, D.C. 20510

Dear Ms. Schroeder,

I am writing to you with regards to the proposed construction of a campground at Fort Belvoir. I do not believe that these facilities are necessary. It would seem to me that with all of the facilities that are available now in the Northern Virginia area such as the Regional Pohick Bay State Park, Fairfax County Park, the Prince William National Park Campground, and many other private campgrounds, that there are more campsites than public demand.

As past President of the Virginia Campground Association, and having been in the business for sixteen years in this area, I am very familiar with the demands for campsites. Recently our Association did a survey of camping in the state of Virginia. The results indicated that for Northern Virginia the occupancy levels for the month of July were only 46%.

It would also seem to me with the economic conditions and the budgetary problems that our Nation is fighting at this time that the government could put these funds to better use in more vital areas.

If we can be of any further assistance to you and Senator Warner in making this decision, please feel free to call upon me.

Sincerely,

Eugene DiRusso

Eugene DiRusso

PRINCE WILLIAM TRAVEL TRAILER VILLAGE
16068 DUMFRIES ROAD
DUMFRIES, VIRGINIA 22026
PHONE (703) 221-2474

October 21, 1992

Ms. Susan Schroeder
Office of Sen. John Warner
U.S. Senate
Washington, D.C. 20510

Dear Ms. Schroeder:

We recently had a visit from a group of engineers from Ft. Belvoir who asked to look over our campground. They informed us that they were intending to build a new campground and marina at Ft. Belvoir on the Potomac River.

We find this surprising at a time when our campground is running at less than 60% capacity even during peak season. A portion of our business comes from the military and retired military visiting Washington, D.C. I am sure this facility would not be charging comparetive rates with the other campgrounds in this area, and, as a result the other campgrounds would lose this business. The State of Virginia would also lose sales tax revenue and Prince William County would lose transient tax revenue.

I also find the use of defense budget funds curious at a time when the defense budget is being reduced, and at a time when military personnel are being cut and sent back into civilian life. I sincerely feel that there are plenty of empty campsites in this area and that the military could better serve itself by using the funds earmarked for this project in more productive ways.

I would also like to take this opportunity to thank Senator Warner for the fine job he has done in representing the State of Virginia.

Sincerely,

David C. Enders

Memorandum

TO: The Honorable Constance A. Morella
1024 Longworth House Office Building
Washington, DC 20515
FR: Norman Gurevich
General Manager
RE: Construction of Campsites/Marina/Cabins/Restaurant on Army Base at Fort Belvoir, Virginia
DA: October 19, 1992

It has just been brought to my attention that plans are now underway to construct facilities on the Fort Belvoir Virginia Army Base that would compete directly with private sector facilities in the greater Washington D.C. Metropolitan Area.

Campsites in particular are often advocated by Government Managers in that they can be constructed without citizen or voter objection, and can be made to fit into a swimming pool or recreation improvement program.

The fact is that there are more then ample facilities for visitors at the hotels, motels, campgrounds and restaurants operated on private property for the current demand.

It is unfair competition to allow overnight accommodation for any boat, automobile and recreational vehicle user and to provide food service alternatives on Federal Property. The local governments do not receive real estate and often local sales tax and user fee's are not collected from operations on Federal Facilities. There is no rational reason to allow active military this additional benefit. The majority of the use of these facilities, if built, would be by retired/senior citizens who can well afford to partake of competitive private sector facilities. Local governments need the tax contributions from this use.

This location in nearby Northern Virginia would impact upon my operation at College Park and the operations of marina's in the Potomac, Patuxent and Chesapeake waterways as well. Occupancy at Cherry Hill Park is in the Thirty Percent area, year round, and has never exceeded Ninety percent on any peak day.

We need your assistance in halting any UNFAIR COMPETITION and in stopping construction of unneeded tourist facilities.

East Coast Touring Company

701 UHLER ROAD EASTON, PA 18042
(215) 252-7774

Testimony Submitted By Robert T. Buesing

President of East Coast Touring Company
Member of the NTA Gov't Relations Committee
Before
United States House of Representatives
Small Buisness Committee
Subcommitte on Procurement, Taxation and Tourism
May 11, 1993

I would like to take this opportunity to thank Chairman Bilbray and the rest of the members of the Subcommittee on Procurement, Taxation and Tourism, for allowing me to share with you my real life experience about the devastating impact that unfair competition has had on my small tour company's business.

In order to understand my story, we must first understand what it is that East Coast Touring Company does. We are a Tour Operator that actively engages in the business of organizing, selling and operating escorted tours, on a for-profit basis. To put it in laymen's terms, we sell an entire vacation experience including transportation, hotel, attractions, and most meals into one all inclusive package. East Coast Touring Company sells 95% of our tours d irectly to senior citizens clubs, school groups, and many others. East Coast Touring Company is truly a small business success story. What started out in 1981 as just a conversation over dinner has turned into a two million dollars a year company employing approximately 14 full and part time employees. In 1992 East Coast Touring Company paid $46,617.00 in Federal, State, and Local Taxes.

I also have become very aware of unfair competition due to the fact that I have served on the National Tour Association Government Relations Committee for the past two years. As you are now aware the National Tour Association is an organization of companies that plan and operate quality tours throughout North America. Presently NTA is closing in on its 600th tour operator member, with over 99% of its members being small business owners like me. Over the last few years the cost of doing business in the wake of recession, increased govt regulation and new tax's certainly effected many small businesses. I am but one of a nation of small business tour operators that have been invaded and disrupted by so called Tax exempt organizations, who have decided to go into competition with my touring company. We realize that the national economy, global markets and inflation are not within your immediate control. However, you can help me with these invaders by tightening up the many loop holes that they operate within. Left unchecked these Tax Exempt Organizations will slow choke out the many small tour company's like mine.

In this next section I will try to explain in as little time as possible my examples of unfair competition.

Example 1 The group leader (a person who represents a group or organization and makes all decisions regarding travel for their group) herself/himself can sit at home and by using 800's can effective make all arrangements for their groups travel. In other words they operate a tour service right off of their kitchen table. And by doing so they can avoid all taxes, regulations, insurances and other operational expenses enabling them to compete unfairly with the for-profit tax paying tour operator. This by far is the fastest and largest growing segment of unfair competition as it pertains to my industry. We need your help in order to keep the many small tour companies profitable and in business for many years to come.

I set forth these next two examples for this committee's review to demonstrate what can happen when a tax supported public entity decides to go into the group tour industry in direct competition with me.

Example 2:
In our area we have many county/city run senior citizen centers that are operated with county and state tax dollars. These centers are very important to many senior citizens who look forward to spending time and enjoying the many activities that these centers offer for them. One of these activities is traveling. However, many center directors, who are employed by the county/city have taken it upon themselves to organize, sell and operate day and overnight tours themselves, instead of purchasing that tour from a for profit small business. I will go into detail in example 3 why this practice by a tax exempt organization is so devastating to my business.

Aside from the previous 2 examples that I illustrated on unfair competition.There is one more that even exist within our own industry. Due to the lack of direction by our Federal,State, and Local governments we at NTA have started a dialog between our members. We do however believe that more direction by our elected officials is despertly need to help the small buisnee

Example 3:
In March of 1993 one of my group leaders came to me with a day tour she wanted to do in a specific region of our state. She informed that she could book this tour directly through the Regional Visitors Bureau. After some phone calls imagine my surprise to find out that this visitor bureau who is a non-profit was operating a full service touring company. Their price for the tour to my customer was $31.00, their price to me was $31.00. Because I do not own my own busses, when adding my profit to the package, I could not sell it to her at the same price that she could do it herself.

You may wonder why I would consider this unfair competition?

After all the tourism promotion agency is there to bring tourism into their area, aren't they?

They have an obligation to increase revenues for their members, don't they?

Yes, they do, but they should not be allowed to hide behind the protection of their **Tax Exempt Status** to compete against a for profit small business that can provide that same product, with better service and protection for the consumer.

Listed below are some facts concerning this example:

1. This visitor bureau received $78,000 dollars in state funds in 1992.

2. Their non-profit states allows lower postage and exemption of most, corporate, state and federal taxes.

3. From the above funds the following is paid for with tax dollars:
   (a) 800 phone number
   (b) All marketing brochures
   (c) All mailings postage paid for
   (d) All trade show costs and marketing

4. They do not have to meet the stringent insurance bonding, and regulatory requirements that a for profit tour company does.

In review of the above you can clearly see that this Visitor Bureau is certainly using the **Tax Exempt Status** to their advantage. Tourism Promotion Agency were created to promote their area, not to operate business that should be left to the private sector. To my knowledge this is not an isolated case. In Pennsylvania alone, there are ten TPA's that are currently offering this type of service and on a national level there are many more. Does this only effect tour companies - definitely not. It effects the counties, states, and even the federal government in lost tax revenue. Calculated below is a quick example of how this occurs:

1992 - This Visitor Bureau
Operated: 104 tours
Total Passenger: 4,160.00
Total Revenue: 128,960.00

State - 1,843.00
Federal - 1,658.00

Times the above figures by the ten (TPA's) currently doing this in my state and you can clearly see that it is not only East Coast Touring Company that is being hurt by this abuse. Note - (above figures based on a 10% profit margin).

In closing, Mr. Chairman, the number of small businesses that are closing each year is increasing. It is these small businesses that make up the base of our nations economy. My American dream has been to be successful in operating my small business. And, yes, to date I have been successful. What the future holds for me is uncertain. The number of one day tours I run per year are down about 60% from ten years ago. The number of 2 - 3 day tours I run per year are down about 30% and this figure is increasing every year.

Yes, I do believe that the cause of the above is due to unfair competition. I recently had the pleasure of hearing Senator George McGovern speak at our last NTA government issues luncheon. He spoke candidly about his venture into the small business world after his retirement from congress. The failure of his Connecticut Inn he stated was due in part to heavy government regulations, paperwork and taxes. We from the small business community do not want special privileges, all we ask is that our representatives in Washington help us compete on a level playing field. If you help us achieve a level playing field, we will be able to continue in business and be a viable player in the economic growth of our great nation.

Once again I thank you Chairman Bilbray and the rest of the members of the Subcommittee on Procurement, Taxation and Tourism. For letting me, just a small businessman from Pennsylvania, explain to you the obstacles that the small business owner is facing today because of competition by **Tax Exempt Organization.**

Sincerely,

Bob Buesing

Bob Buesing
President

TESTIMONY SUBMITTED BY S. BURKETT "DOC" MILNER

FIRST VICE PRESIDENT, NATIONAL TOUR ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON PROCUREMENT, TAXATION AND TOURISM
UNITED STATES HOUSE OF REPRESENTATIVES

MAY 11, 1993

Chairman Bilbray, Ranking Member Congressman Baker, members of the subcommittee, my name is Doc Milner. I am presenting testimony to you today in my capacity as First Vice President of the National Tour Association, and small business tour company owner. In addition to my volunteer position with this association, I am also the Vice President of Capitol Tours in Springfield, Illinois. From the outset, I wish to express my thanks to the subcommittee for agreeing to hold this hearing on an issue that has consistently been identified by the 570 tour company members of the National Tour Association, or NTA, as the number one government related issue impacting each company's continued survival.

For your background, the National Tour Association, headquartered in Lexington, Kentucky, is the primary domestic escorted tour industry association in North America. Our membership includes the most comprehensive cross-section of travel professionals in North America. The association has over 570 tour company members from the Untied States and Canada who package and sell escorted vacations. In addition, we have nearly 2,300 supplier members such as hotels, attractions, restaurants, and airlines, and nearly 800 destination marketing organization members, such as state tourism offices, convention and visitors bureaus, and chambers of commerce.

While there are some 3500 members of this association, it is primarily a North American tour operator driven and run association, and it is these members that are impacted by unfair competition practiced by tax exempt organizations. Because the issue of unfair competition practiced by tax-exempt organizations or associations has been deemed by the tour operator members as the most critical issue facing them, the association spends a great deal of time monitoring and addressing this issue. It is my goal in this testimony to help members of the subcommittee more fully understand the escorted tour industry, how unfair competition affects the escorted tour industry, what public agencies or organizations practice unfair

competition in this industry, and possible solutions that could be undertaken to avoid this conflict.

Let me first begin by providing you with background on the make-up and structure of the escorted tour operator company, followed by NTA's definition of unfair competition. I will then spend the greater part of my time talking about how and why tax exempt organizations engage in unfair competition.

Primarily, the average tour company is small and often family owned, thus requiring the owner to oversee many responsibilities from product development to marketing, operations, personnel and accounting. The company is composed of a small full-time office staff and a core group of tour guides. Using this staff make-up, the company provides its clients with a complete vacation package including transportation, accommodations, some or all meals, sightseeing and a professional escort, all for one price. The competition in this industry is extremely tough from other for-profit tour operators alone, with profits being derived from buying accommodations and meals at group discounted rates, then pricing these tours to the public at a higher rate. Tour patrons consist primarily of senior citizens on a fixed income who cannot afford or are not physically able to travel by themselves.

For each package that is sold, the for-profit tour operator, like all U.S. for-profit businesses, must pay taxes on its revenues, and meet a multitude of government regulations. When marketing these packages, the for-profit tour operator relies most heavily on repeat business, word of mouth recommendations, and direct mail. I point this out because it is the tax exempt organization's exemption from paying taxes, and ability to use government subsidized postal rates, two of my company's largest overhead items, that places tour companies like mine at such an unfair advantage when trying to compete directly with tax exempt organizations. To more fully outline how and why unfair competition is practiced, let me first provide you with a definition of unfair competition.

The National Tour Association defines unfair competition as resulting when a tax-exempt organization -- a non-profit group or government-subsidized agency -- sells goods and services, on a frequent and ongoing basis, using its special privileges. The organization does not use for-profit intermediaries to provide its goods and services; rather, it sells similar products to compete directly with private, for-profit businesses. The main privileges as far as our industry is concerned, are exemption from taxes and reduced postal rates.

While members of NTA are most concerned with tax exempt entities that package and sell escorted vacations, the definition applies to a multitude of services that can be, and currently are being, offered by tax exempt organizations. Make no mistake, tax exempt organizations are very good at making money offering

commercial services. With very few exceptions, revenues handily exceed expenses. In 1990, for example, the American Red Cross, the nation's largest public benefit non-profit, netted $35 million, tax free. In fact, over the past two decades, profits, similar to those realized by the Red Cross, have grown substantially.

Two factors have recently brought enormous pressures on tax exempt organizations to increase revenues. First, declining revenues from public and private sources. Massive cuts in federal aid have led to budget crunches for state and local governments. They responded by cutting their support to tax exempt organizations, leaving these groups in financial trouble. Tax exempt groups have suffered a double hit: As federal monies for non-profit causes fell by $70 billion from 1980 to 1986, contributions from individuals and corporations have leveled off at the same time. Second, expenses have escalated from increased demand for their services. As government funding for social programs dried up, the people most affected were citizens who depended on the government for those services. Now, when nonprofits have fewer resources to spare, more people have turned to them for help.

Caught in this situation, nonprofits have turned to a proven income source to boost their revenues: commercial activities. By entering profitable, popular market segments like the tour and travel industry, they can raise the monies needed to finance their programs and pay their staffs. In fact, the Small Business Administration found that 76 percent of the revenue of an average non-profit group comes from sales, with 14 percent from donations and 9 percent from dues. There are several reasons why nonprofits have looked to the tour and travel industry as a commercial revenue source.

First, tourism is a relatively easy industry in which to start and operate a business. Compared with capital-intensive businesses like grocery stores and automobile dealerships, little money or equipment is needed to start a tour company or travel agency. Also, except in certain states, there are no professional licensure requirements (like bar exams for lawyers) which regulate entry into the industry. Second, the traveling public presents a popular target for non-profit marketers. Because America's demand for travel services remains strong, the major challenges for tour businesses -- for-profit or non-profit -- are finding the trips that market segments want and providing them at reasonable costs. With their tremendous tax-exempt advantages, tax exempt organizations have no problem with either requirement.

To help you more fully understand this issue in practice, allow me to provide you with several concrete examples of tax exempt organizations offering tour and travel services in direct competition with for-profit tour companies like mine.

As a tour operator with a base of operation in the Midwest, I am painfully aware of unfair competition. My biggest competitors are not other tour companies, but churches, museums, and senior citizen organizations operating their own tours as non-profit entities. As a matter of fact, one of these churches operates more tours than most tour companies. This church has its own motorcoaches that were purchased by tax free donations from members, while promoting its tours using reduced postage rates.

More specifically, let me site two more examples.

Muhlenberg County Parks and Recreation Department (PRD)

This agency began sponsoring tours to state parks in 1970. It contracted with ABC Tours, an NTA operator in Muhlenberg City, to provide the itineraries, transportation, and other trip arrangements. PRD advertised the tours to all households in the county through its quarterly newsletter (mailed under for-profit rates) and in a weekly newspaper column (provided free of charge). The tours were priced so that each trip broke even, after ABC Tours received its profits.

In 1987 PRD's director resigned. Seeing the tour programs as a source of revenue, the new director expanded the itineraries to include Caribbean cruises, ski trips to Canada, and Broadway theater tours. He cancelled the arrangement with ABC Tours, bought four motorcoaches, and now conducts the tours using county employees. His newsletter (now mailed under a non-profit permit) and free newspaper advertisements, claim that PRD's tours have "the lowest prices in town," while costed to bring in tax free profits for PRD.

Under the old system, PRD tried but failed to avoid the tricks common to all unfair competitors. Although it did use ABC Tours as a for-profit intermediary, it sold its tours to the general public. Although it mailed its newsletters under for-profit rates, it continued to use the free weekly column in the newspaper. Also, as a unit of county government, its operations were funded largely by the dollars of tax- payers -- including the monies paid by local tour companies now losing business to PRD! (The ABC Tours and for-profit mailing rate elements have been included to demonstrate that few situations involving nonprofits and tour operators are absolutely clear-cut.) However, PRD <u>now</u> competes unfairly on several counts.

First, it creates and sells directly to the public, rather than using a for-profit intermediary. Setting itself up as a <u>de facto</u> tour company, its overhead remains artificially low because it uses non-profit mailing rates, free advertisements, and the subsidized labor of county employees. Thus, it competes unfairly with for-profit tour companies.

Now another example:

Pisgah Tech Community College

To attract more interest from alumni in its programs, the Pisgah Tech Alumni Office planed to offer a "marketing class" in Hong Kong during the Christmas holidays. The six-day, five-night trip featured daily stops in the shopping districts of the Crown Colony, where two professors from the Department of Business Administration will give one-hour lectures over lunch. For the rest of the time, alumni travelers were free to shop on their own. Three hours of continuing education credit was given for the trip.

To promote the tour, the Alumni Office inserted full-page ads in the Pisgah Post alumni newspaper (at no charge) and used its non-profit postal permit to send flyers to 5,000 alumni across the country. While the tour was designed for alumni only, almost half of the 50 spaces were sold to "friends of the college."

Pisgah Tech crosses the line of unfair competition on several counts. First, it used its non-profit advantages to reduce the costs of the tour. Flyers were mailed under reduced postal rates, free ads were run in the alumni newspaper, and college staffers were used to plan and operate the tour. Had Pisgah Tech been forced to cover these costs as a for-profit operator, its prices would have been much higher.

Also, the Alumni Office sold space directly to the public. The supporters who bought space might have chosen an NTA member's tour if they had not gotten the lower price from the college. Structured as a marketing course, the trip was obviously geared toward the general public as a holiday shopping vacation (notwithstanding the three hours of "credit").

Using these examples, it is easy to see why for-profit tour operators cannot compete with tax exempt organizations that offer the same services. First and foremost, I must pay taxes on my services. These taxes must be passed on to tour patrons resulting in higher priced tours. Second, to market my services, I must buy ads in local newspapers. These costs must also be passed on to tour patrons. Finally, I rely heavily on direct mail for marketing and must pay a for-profit rate, substantially higher than those afforded tax-exempt organizations. All these costs must be built in to the final cost of my tour.

All these tax exempt organization privileges are extremely important when you consider the tour operator's clientele. Most often they are senior citizens and/or students. It should come as no surprise that these tour patrons are extremely cost conscious. Even a dollar difference in a tour price can be the difference between booking a tour through my company or another. However, within the for-profit tour operator segment, because costs and overhead are similar, with the exception of

employee costs, identical tour itineraries will be priced similarly, if not the same. However, in comparison, a tax exempt organization's tour package will be substantially less than a for-profit company. The irony is that for every dollar in business that flows through a tax exempt organization, little or no revenue is returned to the government in the form of taxes. Meanwhile, for-profit tour companies go out of business all to frequently due to their inability to compete with tax exempt organizations, further reducing tax revenues flowing back to public coffers.

Now you can more fully understand why for the past several years, NTA members have designated unfair competition as the Association's top legislative issue. In fact, according to a previous NTA survey, 89 percent of the responding members said that their firms encounter competition from tax exempt organizations on a moderate or heavy basis; 46 percent of the members have had competition from 11 or more nonprofits; 98 percent reported that their profits have been adversely affected by unfair competition; and 84 percent have had clients who would have chosen their tours -- if they had not opted instead to take a tax exempt organization sponsored trip at a lower price!

Up to this point, little relief has been afforded by federal, state and local governments. I will add however, state governments have been more open to revisiting the issue. This is due in part to their need for additional tax revenues in view of reductions in their share of federal funding. With little relief offered, and embodying the "strength in numbers" attitude, tour operator members of the National Tour Association have turned to their association to increase pressure for facilitating change. My presence before you today is a reflection of this attitude. To turn the tide in this battle, the association continues to press the fight on several fronts.

In Congress, NTA has attempted to effect legislative changes, particularly in the unrelated business income tax (UBIT) area, to counter unfair competition. In accordance with UBIT laws, every tax exempt organization with annual revenues exceeding $25,000 must file Form 990, its version of the annual federal tax return, with the Internal Revenue Service. If the group has earned more than $1,000 that year from "unrelated" sources (not related to its chartered purposes), then it must file Form 990-T and pay the unrelated business income tax (UBIT) on those monies. In recent years, however, the Form 990 returns have been studied to determine how well tax exempt organizations have complied with the tax laws for tax exempt groups. Those efforts have shown that a significant number of organizations have underestimated the UBIT owed or have not declared any UBIT at all.

Several years ago, under the leadership of Congressman Pickle, NTA monitored a set of proposed UBIT reforms in the Oversight Subcommittee of the House Ways and Means Committee. The

reforms would have tightened IRS regulations governing UBIT collection from tax exempt organizations. Unfortunately, Congress did not wish to battle with the tax exempt organization establishment at that time and the legislation died. During the interim, NTA has continued to produce and distribute periodic legislative alerts to NTA members that have generated thousands of letters to Capitol Hill, pushing for these changes in the tax code.

Within the federal agencies, NTA has also attempted to effect regulatory changes to combat unfair competition, and insure that current regulations are enforced fully. In particular, the association fought successfully for the development of a new version of Form 990. Now the form calls for a more complete disclosure of the sources of a nonprofit's unrelated business income. Using this information, government officials can determine how large the problem of unfair competition has become. In addition, pressure brought on the IRS from this and other organizations representing for-profit entities impacted by unfair competition, led the IRS to audit several universities to determine the extent of their unrelated business income tax practices. These audits are currently ongoing.

NTA also supports the Taxpayer Compliance Measurement Program, an IRS initiative to study at random the tax returns of different taxpayer groups. The program will show how accurate and timely the returns of tax exempt organizations have been in recent years. For example, an earlier study found that only 27,000 nonprofits had declared any unrelated income -- and 30 percent of those groups declared it only after IRS auditors had reviewed their forms!

Working with other industry groups, NTA has urged the U.S. Postal Service to tighten its rules on non-profit mailing rates, so that travel promotions and brochures will not be sent to customers under reduced rates. This position has also been advocated to the Post Office and Civil Service Committee of the U.S. Congress.

And finally, at the state level, NTA has attempted to effect both legislative and regulatory changes in targeted states. In 1990, NTA and the Business Coalition for Fair Competition (BCFC), represented here by Jim Santini, drafted a model unfair competition bill for state legislatures. The bill is being used as a model by for-profits in working towards passage by their respective state legislators. This bill prohibits government-subsidized and private non-profit competition in commercial activities, and establishes a Private Enterprise Review Commission to hear and settle complaints on unfair competition cases.

NTA has remained activity involved with BCFC's activities at the state level leading to numerous states introducing legislation authorizing studies on the growth of unfair competition and its

impact on small business; prohibiting unfair competition by government agencies and non-profit groups; outlawing specific types of non-profit commercial activities, or privatizing certain state activities; as well as creating more stringent reporting rules for tax exempt organization commercial activities. While the aforementioned efforts by NTA to fight unfair competition are extensive, there are many others I have not mentioned.

Waging the battle against unfair competition will continue to be a lengthy and challenging experience. While NTA, in support of its tour operator members, has continued to combat unfair competition, action must be taken by the Congress if the practice is to be ended. First, as politically painless and readily accomplished, I would suggest that Congress appropriate additional funding to the IRS, specifically earmarked for increasing compliance of unrelated business income tax laws. While the IRS has told us they understand the problem and sympathize, their funding levels are grossly inadequate to effectively combat the problem. If funding is not given, NTA has been told that they would at least like a signal from the Congress that this is a priority issue. In addition, to more fully understand the extent and complexity of the unfair competition issue, Congress should, at least, direct a study to review the matter, with appropriate recommendations for legislative changes. These suggestions will allow the Congress to begin recouping some of its lost tax revenues, as well as learning more fully how much revenue is being lost.

More long-term and difficult, changes to the unrelated business income tax laws must be made. As a start, members of this subcommittee can revive Congressman Pickel's legislation, or ask a member of the Ways and Means Committee to reintroduced the measure and hold hearings. Finally, copies of the model unfair competition bill currently being introduced and debated in states nationwide, should be reviewed by members of this subcommittee for a possible draft to be introduced in Congress. While these suggestions are more difficult than the first ones I mentioned, mechanisms to begin making needed changes are already available. I, or Jim Santini, will be happy to provide any member of the Congress with a copy of the model bill upon request.

In conclusion, I will reiterate that the issue of unfair competition practiced by tax exempt organizations is depriving public coffers of billions of dollars in tax revenues, while putting for-profit tax revenue sources, like Capitol Tours, out of business. Unless changes are made, tax exempt organizations will continue to offer their commercial services, generating billions of dollars in tax-free profit. As it now stands, tax exempt organizations can continue to follow their own golden rule. "He who holds the gold, makes the rules". I submit to members of this subcommittee, its high time we change the rules.

Kampgrounds of America, Inc.

Written comments to the U.S. House of Representatives Subcommittee on Procurement, Taxation and Tourism on May 11, 1993 by Homer Staves, Vice President - Customer Service, International Marketing, Kampgrounds of America, Inc.

The book Americans on the Road by Warren James Belasco points out that auto camping, the forerunner of modern recreational vehicle parks, started with the advent of the automobile. From the start, people would take their automobile and head out into the country and pitch a tent to spend the night. In the beginning it made no difference where they pitched their tent, whether it was private land or Federal land, because the total number of people was very small. In fact, many farmers in the early 1900s welcomed campers as a new source of customers for the produce they grew on their farms. This random squatter stage lasted only a few years. By the early 1920s auto campers generally stopped not along the roadside, but in public campgrounds and municipal parks. Somewhere between 3,000 and 6,000 auto camps existed in the country by 1920. Most of these were located in the West. The camp that was recognized as the progenitor of the auto camping park was Denver's Overland Park, established in 1915. This auto park spread over 160 acres along the Platte River, with 800 lots, and would accommodate over 2,000 auto campers. It had running water and was lighted by electric bulbs. A three-story central clubhouse had a grocery, kitchen and grill, steam table, comfort stations, showers, barber shop, lunch counter, and laundry room, with eight tubs. It was estimated that in 1912 only twelve auto campers made the arduous trans-continental run. However, by 1921 it was estimated that 20,000 Americans drove cross-country. It was also estimated by the New York Times that out of 10.8 million cars on the road in 1922, 5 million would be used for camping.

Executive Offices P.O. Box 30558 Billings, Montana 59114 Phone (406) 248-7444 Fax: 406-248-7414 Telex: 9102400821 KAMP GROUND

Just as the camping boom started in the West, so did the emergence of fee camping. In the 1910s, some farmers in the West charged a dollar a night to camp in their fields. The East developed a little more slowly, with the first fee camp in New England opening in 1921. In 1925, only nine of Colorado's sixty-four listed camps were privately run. By 1928, sixty-five were private, and only twenty were public. The same held true throughout the United States. While in the early stages of auto camping, many campers pitched their tents on Federal land as they traveled across America, the real growth in Federal campgrounds did not occur until the depression era of the 1930s, when Congress, at the urging of President Franklin Delano Roosevelt, created the Civilian Conservation Corps. The purpose of the CCC was to relocate unemployed, restless young males away from the cities to the countryside to avoid potential problems similar to the veterans' march on Washington. The campgrounds developed were make-work projects, rather than projects initiated to serve a need for campgrounds.

Private sector and Government campgrounds have co-existed since the beginning of our industry. Traditionally, private campgrounds have provided amenities, such as hookups, hot showers, flush toilets, stores, and more, while Government campgrounds provided basic "bare bones" camping spots in beautiful primitive areas. Because of the remoteness of Government campgrounds and lack of facilities there was no major competition between the tax paying fee camping by the private sector and the tax consuming free camping provided by the Government. However, the camping industry has gone through some major changes beginning in 1978. From 1978 to 1980 the number of recreational vehicles built in this country for camping declined from about 400,000 a year to about 100,000 a year. Since 1980 production has leveled off at

approximately 200,000 a year, or less than half the units produced back in the '70s. According to Woodall Publishing, the number of private campgrounds declined from 7,766 in 1982 to 7,332 in 1990, a 6 percent decline. This decline in privately owned campgrounds and in RV production occurred because of a change in family demographics, available jobs, and lifestyle. Obviously the private sector responds quickly to profit and losses and resulting cash flow. As fewer and fewer customers come in the door, income declines. Total expenses continue to increase, due to such factors as increased costs of insurance, labor, taxes, utilities, and Government marketed programs such as ADA. (For more information see Pages 9 and 10). With declining profits, more and more of the tax paying private sector campgrounds have been forced out of business. By contrast, the tax consuming Government campgrounds have increased during this same period. Since Federal land agencies see absolutely no correlation between income and expenses, the Federal Government has continued to build more and more campgrounds even as the market declined. As an example, in 1982 the Rand McNally campground directory listed 3,339 Forest Service campgrounds in the United States. At various public meetings, the Forest Service is now claiming to have 4,200 campgrounds, or a 26 percent increase in the number of campgrounds. During the same time period, private campgrounds have been declining. In addition to the increase in campgrounds in the Forest Service, there has also been a steady corresponding increase in the number of campgrounds developed by BLM, The Corps of Engineers and National Park Service.

I would like to review some of the factors which have created this disparity. First and foremost is price. Private campgrounds must charge a fee sufficient to generate a pretax profit after they

cover all of their operating expenses. Private campgrounds must pay minimum wage for all help they use at the campground, Government campgrounds trade a free site to people to stay on the campground and act as a host with no cost whatsoever, a practice that is illegal for the private sector. Private campgrounds are required to pay property taxes, income tax, sales tax, and bed taxes. Government campgrounds do not. Private campgrounds have to pay for liability insurance, Government campgrounds do not. Pages 11 and 12 show the average revenue and expense and operating profit for 225 KOA Kampgrounds. These numbers show operating expenses ranging from a low of $12.86 per camper night to a high of $15.60. To break even private campgrounds must charge a minimum of $13.00. By comparison most Government campgrounds advertise rates of five to six dollars per night, and they also accept the Golden Age Passport for 50 percent reduction, meaning they have an effective rate of three or four dollars a night. Obviously a tax paying private campground cannot compete with this price range. Even worse competition occurs where the Corps of Engineers is required by Federal legislation to provide <u>free</u> camping.

A second area of unfair competition is in the facilities. Historically the tax paying private sector has been able to compete with the tax consuming Government campgrounds by providing more services in the way of water, sewer, electrical hookups, hot showers, swimming pools, and other amenities. The trend now, however, is for Government campgrounds to modernize and add these improvements without charging rates comparable to the tax paying private campgrounds. If this trend continues, there is no way the private sector can continue to compete with the public campgrounds.

A third area of competition is in the operation seasons. In market areas where all campgrounds are full during the peak summer seasons, such as in the Grand Canyon/Williams, Arizona area, most campgrounds fill up regardless of price during July and August. However, during the shoulder seasons - April, May, June, September and October - the Government campgrounds stay open, and with their low rates, take all of the business, so private campgrounds are unable to compete for the very limited number of customers.

These three areas are the primary concern of the private sector when it comes to unfair competition from Government campgrounds. There are five steps that should be taken to reduce unfair competition. First, Congress should pass legislation requiring Government campgrounds to charge user fees the same as those charged by the private sector at nearby campgrounds. Second, Government properties should be prohibited from expanding the amenities provided. The Government land agencies should retain their historic role of providing a natural type experience to the customer, with minimum of development. Third, Government campgrounds should only operate during the peak season, when there is a demonstrated need for additional campsites in the area. Fourth, to be truly equitable, the Federal Government should make the Golden Age Passport applicable only to admission to the National Parks and not to user fees for camping registration, and Fifth, legislation must be passed to direct the Corps of Engineers to charge user fees on their facilities.

I would also like to address specific comments at specific Government agencies where unfair competition does exist.

First, the Forest Service has the largest number of tax payer owned campgrounds, with over 4,200 locations scattered throughout the United States. Many of the Forest Service locations are small, basic campgrounds in remote areas which provide absolutely no competition to the private sector. We have no quarrel with those facilities, and think they should be maintained in a clean, sanitary condition. I would also like to commend the Forest Service for their willingness to explore the possibility of public/private partnerships for the development of campgrounds in areas that are economically suitable for private campground developments, and also for their willingness to explore the possibility of setting prices at a level comparable to that charged by the private sector. However, I would also like to criticize the Forest Service for expanding their campgrounds with deluxe full service facilities such as Payson, Arizona. This is a case where the Forest Service did an incomplete feasibility study six years ago, and last year began development of a campground with full hookups, hot showers, and all types of modern amenities. In the meantime, a full service KOA Kampground was developed in the area by a KOA licensee. The Forest Service did not take this into account in its feasibility study, did not go back and review its studies, but rather began construction without a proper market study. The Forest Service also recently announced their intent to develop a complete modern campground at the edge of the Grand Canyon, with full hookups, hot showers and other amenities. The nearest private campgrounds are more than twenty-five miles away from the Canyon because of the large amount of land owned by the Federal Government. This is a case where the private sector cannot build in the area the consumer wants, simply because of the monopoly of real estate. This is a case where the Forest Service should only look at private/public partnerships to develop the necessary facilities.

The Bureau of Land Management also has a large number of campgrounds; however, in most cases, BLM campgrounds are located in remote areas and provide minimal competition to the private sector. This program should be encouraged, and competition should be kept to a minimum.

The Army Corps of Engineers is a unique situation that was singled out by Congress in enabling legislation. The Corps of Engineers is required by Government legislation to provide free camping at tax supported facilities. This law should be changed and the Corps should be instructed by Congress to charge a rate comparable to the rate charged by the private sector for nearby facilities.

At the present time, many military establishments have built deluxe campgrounds that are provided free or at a very low rate to not only retired military people, but also to anybody coming through the area who knows where to go and who to ask. Specific examples of this can be found at Fort A.P. Hill in Virginia, where the military base provides camping for snowbirds as they go to Florida for the winter, and there is now a proposal to build additional camping facilities at Fort Belvoir in the same market area. This is in an area where the private sector campgrounds operate at less than 50 percent occupancy, even in the peak month of August.

And finally, the National Park Service operates campgrounds in most national parks, charging a rate that is only a fraction of that charged by the private sector outside of the parks. The Park Service should raise their rates to be comparable to that charged by the private sector and

consider closing many of the campgrounds in the national parks, or at least shortening the season that they are operated.

In closing, I'd like to point out that not only are campsites provided at rates below cost to U.S. citizens, but the Federal Government is now promoting these tax subsidized facilities to the foreign market in direct competition to the tax paying private sector campgrounds.

I urge this committee to propose the five legislative changes suggested earlier.

1. Require fees that are comparable to those charged by the private sector.
2. Prohibit Government facilities from adding full service amenities.
3. Shorten operating seasons to peak times.
4. Eliminate campgrounds from Golden Age Passport.
5. Allow Corps of Engineers to charge user fees.

Reprinted from the 1993 KOA Directory Road Atlas and Camping Guide

"As My Grandmother Used To Say..."

Folklore has it that everyone's grandmother used to be full of sayings that reflected traditional wisdom; such things as "Waste not - want not" or "A stitch in time saves nine"... whatever that means. Actually, my grandmothers were a couple of South Dakota farm wives who were given to saying things like, "You kids sit down and be quiet," and "Don't talk with your mouth full." While I never heard them verbalize great philosophical pronouncements, most of the things that we attribute to somebody's grandmother's wisdom usually turn out to be true. High on the top of the list is "There ain't no free lunch."

... business ... not some great big impersonal entity out there that has bottomless pockets to be picked.

To meet a December printer's deadline for the 1993 KOA Directory, I'm writing this note to KOA Kampers in August. Still ahead for Americans are congressional elections and a presidential election. Between the time that I'm writing this and the time that you'll be reading it, we will have had dozens, if not hundreds of national and local politicians try to persuade us, the American voters, that, in fact, we can have added services and benefits from the government at no "direct cost" to us. All we have to do is allow legislators to write laws to address every social problem in the country and then pass the cost on to "business" and no one will ever know the difference. How I wish that were true. The fact of the matter is "business" is not some great big impersonal entity out there that has bottomless pockets to be picked. "Business" is, for the most part, people just like you and me who do such things as operate restaurants, day care centers, dry cleaners, corner convenience stores, tire stores, neighborhood printing shops, or own and operate a KOA Kampground. When "Big Brother" passes another law and dictates that business will provide one more facility or one more benefit, the only thing we can be sure of is that in the end, the cost of providing for that facility or benefit is coming out of your pocket and mine. Business, at least that business which is well managed enough to survive year in and year out, knows that all costs must be passed on to the customer. It makes no difference whether the increase is in the wholesale cost of a can of beans, a gallon of gasoline, or a government tax.

As I'm writing this piece, we're rapidly digesting the increased cost of doing business as a result of the Americans with Disabilities Act. I read recently that the bill as passed began as a proposal to ensure fair treatment for some 3.5 million Americans who are either wheelchair bound, blind, hearing impaired, or affected by one of the handicaps we've traditionally viewed as being disabling. Certainly none of us quarrel with this objective. However, by the time the Congress got through reacting to special interest pressures, one in six Americans is now legally defined as being disabled, at least that is how the regulators are interpreting the law. Anyone who has drunk too much, been addicted to drugs, contracted AIDS or venereal diseases, or experienced any number of problems, is now considered legally disabled and entitled to protection by the American taxpayer. (That's you and me, lest we forget.) Who knows what laws Congress may have passed by the time this piece is in print and you read it. Just this week I read that one of the proposals being kicked around by Congress is a 10 percent national value added tax to pay for a national health insurance program.

Now that, as I understand it, is not a tax to replace any other tax, but simply a tax that takes 10 percent of every transaction in our economy and gives it to the government. The effect of such a tax would be to reduce the value of our productive economy by 10 percent. Some look with great envy at the Canadian health care system. If you've visited Canada lately, you have probably had a Canadian taxpayer tell you that their economy is strangling, and the Canadian people are just about taxed to the limit. Those who live close enough to the American border flow across weekly to do their grocery shopping to avoid the impact of social services taxes on their daily lives in Canada.

Continued on page 8.

Continued from page 2.

Costs are rising in the campground business at a rapid rate, and for the past three years camping fees have not kept up with the increase in costs. As a result, I reluctantly predict that you're going to see more increases in camping fees in the next couple of years than you've seen in the past few. The alternative would be to take the approach of the United States' airline industry and underprice ourselves into oblivion. I can assure you that there will be campgrounds and RV parks which will attempt to survive by discounting. I also predict that they will go the way of Eastern Airlines, Midwest Airlines, and Pan Am, and those others who found themselves out of business as a result of selling product for less than it costs to provide it.

...in the end the cost of all such actions must be borne by you and me as consumers and individual customers.

Montana is a ranching state. We who live in Montana love to tell farmer jokes. I presume farmers tell rancher jokes, or trucker jokes, or. . . I recently heard about the farmer who discovered that he lost money when he took a truckload of grain to town to sell, so to solve the problem, he bought a second truck.

As I was thinking about ways to evaluate the impact of cost increases on KOA Kampgrounds, I reviewed the financial statements on one rather average KOA Kampground in New Mexico. In the three years between 1988 and 1991, the campground's registration fees increased 2 percent. Since 1988 they have experienced an increase in the national minimum wage rate, increases in Worker's Compensation rates, increases in federal Social Security and tax indexing, a doubling of employer paid health insurance costs, and as a result, their personnel costs have increased 26 percent. During that same period of time, liability insurance premiums increased 20 percent, repair and maintenance costs increased 10 percent, the cost of cleaning supplies increased 26 percent, etc., etc. Their suppliers have people costs and taxes to pay, too. They must pass their cost increases on to us, their customers.

I suppose you've heard about the football star who failed a critical exam and was in danger of being dropped from the team. His coach prevailed upon the prof to let the young man take a makeup exam. Knowing how important football is in big time colleges these days, the prof put together a few simple questions. One by one the star missed in his replies. Finally, the prof said, "One last chance. What is two plus two?" "Four," replied the star, at which time the coach spoke up and said, "Aw, come on, prof, give the kid another chance." Obviously, some people can add things up better than others. I believe that as long as all of us understand that in the end the cost of all such actions must be borne by you and me as consumers and individual customers, we have no problem. If we, individually and collectively as a society, determine that we want and need more wilderness area in our country, it is clearly our privilege as a society to make that determination. If we determine that it is a national priority to protect endangered species, that is clearly our privilege as a society. If we determine that we are going to provide total health care for everyone from birth until death, that, too, is our privilege. The fact of the matter is that if we make decisions through our elected representatives, we must be prepared to pay the costs that result from these decisions. The costs are not always identifiable, but they are always there. For example, the cost of protecting the spotted owl and the old-growth forests of the Pacific Northwest will most likely reflect themselves in the increased cost of housing for young families, as the cost of timber increases in the face of reduced supply. Not very complicated, it seems to me. If it is our determination that we're going to provide health care for everyone, then we must be prepared to give up something else in our lives to pay that cost, whether that something be free time, disposable income, or available funds to set aside for our own retirement. Just simply mandating that "business" will provide health care or that the government will provide health care is not going to make that or any other service available at no cost. North America is a place of wide and diverse political and social options. We tolerate those we call conservative and those we call left wing. That's how the system works. Certainly I wouldn't presume to try to influence your position on the spotted owl issue or any other situation of national importance. I'm simply trying to remind us all through a couple of examples that all decisions have costs.

So, I beg your understanding the next time you walk up to the desk at a KOA Kampground, or at a dry cleaner's or at a convenience store. Please don't take out your unhappiness over increased costs on the person across the counter from you. They are simply passing on to you the bill for the costs that are assessed against business (at least those businesses that will survive) that come to us as mandated costs of doing business as a result of increased litigation, more lawyers, increased taxes, or more government programs that siphon money out of our pockets and yours. I can assure you that the owner of every KOA Kampground would like to not pass those costs on to you. More importantly, they would like to not have those costs in the first place. In the end, of course, they are just like you and me. They are consumers and taxpayers, and they pay their share when they go to the supermarket or the dry cleaners, or pay their taxes or their utility bills.

As someone's wise old grandma must have been fond of saying, "There ain't no free lunch."

Arthur M. Peterson
President

KAMPGROUNDS OF AMERICA, INC.

INFORMATION FOR PROSPECTIVE FRANCHISEES
REQUIRED BY THE FEDERAL TRADE COMMISSION

KAMPGROUNDS OF AMERICA, INC.
550 NORTH 31ST STREET
P.O. BOX 30558
BILLINGS, MONTANA 59114

THE DATE OF ISSUANCE OF THIS DISCLOSURE IS MARCH 31, 1993.

To protect you, we've required your franchisor to give you this information. We haven't checked it and don't know if it's correct. It should help you make up your mind. Study it carefully. While it includes some information about your contract, don't rely on it alone to understand your contract. Read all of your contract carefully. Buying a franchise is a complicated investment. Take your time to decide. If possible, show your contract to an advisor, like a lawyer or an accountant. If you find anything you think may be wrong or anything important that has been left out, you should let us know about it. It may be against the law.

There may also be laws on franchising in your state. Ask your state agencies about them.

Federal Trade Commission
Washington, D.C. 20580

EXHIBIT IV

THESE PER CAMPER NIGHT AVERAGES OF REVENUES, EXPENSES AND OPERATING PROFITS ARE AVERAGES OF 225 SPECIFIC FRANCHISES AND SHOULD NOT BE CONSIDERED AS ACTUAL OR POTENTIAL RESULTS.

KAMPGROUNDS OF AMERICA, INC.
1991 PER CAMPER NIGHT AVERAGES

Camper Night Range	UP TO 5,000	5,000 TO 9,999	10,000 TO 24,999	25,000 & UP
REVENUE				
Registrations	15.87	14.64	15.26	15.71
Merchandise Sales	5.41	4.27	4.57	4.03
Other	3.20	2.64	1.48	2.77
TOTAL REVENUE	24.48	21.55	21.31	22.51
Cost of Sales	(4.20)	(2.98)	(3.28)	(2.87)
GROSS PROFIT	20.28	18.57	18.03	19.64
OPERATING EXPENSES				
Wages & Benefits	3.35	2.99	4.52	5.62
Utilities	3.38	2.65	2.19	2.20
Repairs	2.04	1.32	1.19	1.05
Supplies	0.85	0.63	0.55	0.40
Royalties	1.32	1.31	1.33	1.41
Advertising	1.14	0.94	0.70	0.78
Property Taxes	0.93	0.65	0.59	0.60
Insurance	1.60	1.07	0.78	0.79
Auto	0.57	0.34	0.24	0.20
Other	0.42	0.96	0.81	1.52
Total Operating Expenses	15.60	12.86	12.90	14.57
OPERATING PROFIT	4.68	5.71	5.13	5.07

(1) Group averages were calculated by dividing the total of all revenue, cost and expense lines by the number in each group that reported that line. Average camper nights were calculated by dividing the group total camper nights by the number of campgrounds in that group. Line results per average camper night were calculated by dividing average revenue, costs and expenses by the average camper night figure for the group.

(2) Owners and employees wages and benefits include reported labor and benefit costs of both the hired employees and campground owners. It was not feasible to break out owners' compensation in order to report payroll costs other than the owners as a separate line.

(3) Interest expense, depreciation and lease payments (rents) for the campground property (if any) are not included in operating expenses and, therefore, are not deducted from operating profits.

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